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**SOCIAL GOALS AND ECONOMIC  
INSTITUTIONS**



*"A people may prefer a free government, but if, from indolence, or carelessness, or cowardice, or want of public spirit, they are unequal to the exertions necessary for preserving it; if they will not fight for it when it is directly attacked; if they can be deluded by the artifices used to cheat them out of it; if by momentary discouragement, or temporary panic, or a fit of enthusiasm for an individual, they can be induced to lay their liberties at the feet even of a great man, or trust him with powers which enable him to subvert their institutions; in all these cases they are more or less unfit for liberty: and though it may be for their good to have had it even for a short time, they are unlikely long to enjoy it."*

—JOHN STUART MILL

SOCIAL GOALS  
AND  
ECONOMIC  
INSTITUTIONS

BY

Frank D. Graham

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## PREFACE

SINCE this book is of the nature of a confession of faith, and an argument for the conviction that is in me, it would be futile to attempt to acknowledge, in detail, the debt I owe to other writers. Echoes from much, or all, of the significant literature that I have ever read are, no doubt, present in the sequel. The amount of my relevant reading is what I have been able to encompass in a now not short lifetime of reasonably assiduous devotion to social studies. Specific references, in the notes, touch but a minor fraction of this reading, and many of the ideas, good or bad, that are here expressed are doubtless derived from sources of which I am no longer even conscious. How far the eclecticism that I have practiced has been tempered with wisdom, in the grappling to myself of the ideas of others, is not, of course, for me to judge.

As I look back, it seems to me that three supreme writers—H. G. Wells, Jeremy Bentham, and Thorstein Veblen—have been of surpassing influence upon my frame of thought.

It was from Wells that I first received a stimulus to my imagination. Without such a stimulus one must remain a dull clod or, at best, a more or less engaging lower animal. With much of Wells, it is true, I cannot agree. Indeed he never, for very long, agrees even with himself. But, for all that, he has been a great inspiration to me and is, I think, one of the world's great citizens, a constant agitator for magnanimous things, a seer of the type indispensable to human advance.

The bell-like clarity of thought of Jeremy Bentham is a necessary antidote to the inspirational effect of a man like Wells. The cold logic of the analyst is here brought in to supplement, or correct, the arid or over-fertile imagery of social dreamers who, however brilliant, are far from infallible. Bentham, it seems to me, towers above all social scientists, not only in the precision of his insight into means (the sole function of the scientist qua scientist), but also in the clarification of ends and in the fecundity of his powers of realistically conceived social invention. Bentham, himself, in his *Chrestomathia*,<sup>1</sup> defined invention as "imagination taken under command by attention, and directed to the accomplishment of

<sup>1</sup> Cited in Graham Wallas, *Men and Ideas* (George Allen and Unwin, Ltd., London, 1940), p. 36.

some particular . . . end in view," and he was preeminent in this process. Like many other inventors it was Bentham's fate, and he was happy in it, to have his social discoveries appropriated by others to their own credit. But, in the fine words spoken of him by Talleyrand, "though all the world has stolen from him, he is forever rich."

Bentham's felicific calculus, as is in some degree true of all measuring-rods, had grave defects, and should ere now, I think, have been discarded for a better criterion. In its time, however, it did yeoman service; even at the very end of the nineteenth century, Sir Henry Maine could say that he did not know of a single legal reform effected since Bentham's day which was not traceable to his influence.

As a recent writer has pointed out,<sup>2</sup> Bentham achieved a perfect reconciliation of individualism and societism—of the general interest with that of the individual—and a union of equality in the chances of life with liberty in its pursuits. Most of the calumny which has been heaped upon him, by those unworthy to unloose the latchet of his shoe, issues out of a gross misinterpretation of his views, probably without the calumniator having gone to the trouble of reading the master he was attacking or, at any rate, of seeking to understand what he had said. But Bentham was no doubt wrong in his uncompromising assault on asceticism. With something not far from unanimity the great moralists have given their blessing to the ascetic virtues. This is not because asceticism is good per se (any such notion is perverse) but because it is a means to (moral) power. Bentham's error, in my view, lay in his failure to perceive that it is power, rather than pleasure, that men desire, even if some of them seem to desire power only that they may bathe in sensuous (or sensual) pleasure. Bentham's refusal to make any sharp distinction between human and other sentient creatures also thrust him into some logically untenable situations.

Upon my notion of the importance of a union of the imagination of Wells with the uncompromising clarity and realism of Bentham, Thorstein Veblen, in his lucid and seductively satirical writings, brought to bear a sobering contemplation of the apparently contradictory motivations of humankind. This seemed to make *any*

<sup>2</sup> W. Stark, "Jeremy Bentham as an Economist," *Economic Journal*, vol. LI, no. 201, April 1941, pp. 56ff.

social calculus impossible. The dichotomy on which Veblen dwelt, however, can, I think, be synthesized in the light of the concept of the search for power as the preeminent galvanizer to human action. It is the thirst for power which is the sovereign master under whose governance nature has placed mankind. This is not a dual sovereignty, such as that of pleasure and pain, to which Bentham felt that men were subject, nor is it a schizophrenic monarch such as Veblen had in mind.

As we seek pleasure, or flee from pain, we follow with a single mind after the power which will enable us to realize our desires. But power is sought not only as a means to ends quite beyond pleasure and pain (even as broadly construed as Bentham meant them to be) but as an end in, and for, itself. Pleasure and pain, indeed, may be considered to be mere by-products of the presence or absence of power. It is quite possible, moreover, that men may be consistent in a larger purpose while pursuing courses that, to Veblen, seemed to be mutually frustrating.

Neither Bentham's hedonism nor Veblen's Olympian satire, though illuminating, are therefore adequate as a guide to social conduct under any inspiration whatsoever that men may have. Pleasure and pain are not the whole of life, whereas the "instinct for workmanship" and the pursuit of "conspicuous waste" are but seemingly incongruous effects of a common cause. It is my hope that all this will, in due course, be made clear.

I cannot bring this list of personal acknowledgments to a close without mentioning the great help that I have had from my student-assistant, Mr. Dillon Glendinning. I am not sure, indeed, whether mere justice, rather than any generosity, would not require that I speak of him as a collaborator rather than as an assistant. On the other hand, since he has had no responsibility for the final word, it might be unfair to subject him to the contumely which will no doubt be visited on this book in some, if not in all, of the quarters in which it may be read.

I am also under deep obligation to Professor Clarence D. Long of Wesleyan University, who read the complete manuscript and made many excellent suggestions, and to Professors McIsaac and Strayer of Princeton University, who did me the same service on individual chapters.

For financial aid in the preparation of the book I am indebted to

the Oberlaender Trust for a fellowship, granted me in 1936-1937, for investigation, within Germany, of the means there adopted for the solution of the problem of unemployment. While impressed with the success of the Germans I was revolted by the means that they had used and am convinced that such means, while far from improbable of adoption in this and other (still partially) democratic countries, are quite unnecessary to the attainment of the desired result.

I wish also to acknowledge receipt of a loan from the Research Fund of Princeton University to cover clerical and other similar expenses, and to thank the publishers of several books, from which quotations have been made, for permission to reproduce the cited passages.

F. D. G.

*Princeton, N.J.*

*April 1942*

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## INTRODUCTION

THE construction of Utopias is of perennial interest and, in one form or another, is an essential preliminary to conscious social progress. Yet the word Utopia is (rightly) in disrepute. This disrepute arises from the tendency of architects of the future to dream of a social bread that cannot be made of the wheat that is at hand. With them the run of the wheat is presumed to be much better than is in fact the case. They dwell on the alleged natural goodness of man and on the sweetness and light which would pervade the world if this goodness could only be released. The response of the cynics is to assert that the heart of man is deceitful and desperately wicked and to cast disdain on all those who yearn for an amelioration of the *status quo*.

The truth, no doubt, is that the hearts of men are neither immaculately white nor black, that the spots upon them are not of the same character or magnitude, and that, regardless of spots, they do not crave the same things. Mr. H. G. Wells in his *A Modern Utopia*<sup>1</sup> points out that none of his predecessors in the field had paid any attention to biological facts.<sup>2</sup> The citizens of their imaginary societies were all very much alike; in the eyes of their creator they were magnanimous, beautiful, and homogeneous. Yet, as Wells says, the essential feature of biological development is differentiation. Since this is so, no closely defined pattern of social life, no social unity in any narrow sense, could be wholly satisfying to most, or even many, of the members of which society is at any time composed. Free play for the idiosyncrasies of individuals is a *sine qua non* of a social organization which is not to run afoul of that vital principle of variety on which the ascent of man has been built and still depends. Variety is not merely the spice of life but its very essence. Idiosyncrasies, of course, make for conflict yet the social task is not to suppress such conflict but to turn it into socially innocuous or beneficial forms and channels.<sup>3</sup> The ideal is

<sup>1</sup> Chapman and Hall, Ltd., London, 1905, *passim*.

<sup>2</sup> This might be disputed in the case of Plato (and perhaps some other writers) since Plato divided the denizens of his Republic into classes distinguished by alleged biological differences. But Wells's statement is true in general and true without qualification if one speaks of biological facts rather than fancies.

<sup>3</sup> The more primitive the society the fewer may be the internal conflicts. Thought

a harmony in variety; this is the only sort of unity that can result in anything but ultimate stagnation.

In fine, it is impossible to imagine a society as *completed*, to the satisfaction of all its members, unless those members had lost the distinguishing characteristics of human beings. We shall always have discontent. Some of this may be divine but much will be distressingly human. The most that we can hope is that it should be unwarranted. It is childish to hope for universal bliss since there are no conditions whatsoever that would insure it. We must set our sights at levels considerably below this or we shall be shooting in the air. Weakness and strength—which are relative terms referred to some far from fixed criterion—we shall have so long as men are men. The problem of failure will, in consequence, always be with us. Tastes will always differ. Reformers, it may be suspected, will always be impatient and perhaps they should be. It would, in any event, be asking the impossible to expect that any of them would approve, in detail, the structure of another reformer. Reformers, moreover, are not unique in this respect. No status will ever be satisfactory to any active man upon whom it is irrevocably imposed.

The writers of Utopias have never recognized this simple fact except, unconsciously, in the machinery they propose for the administration of their polities. The regimentation in them is camouflaged but cannot be concealed. It is astonishing, for instance, to note how closely the political machinery of Edward Bellamy's *Looking Backward*<sup>4</sup> parallels that of the dictatorships which have grown up since his day to establish social conditions of which it is impossible to suppose that Bellamy would have approved. Even Mr. Wells, in spite of his effort to preserve what he believes to be the peculiar distinction of his own book, thrusts the majority of his Utopians into a mold, fitted upon them by the "Samurai," an organization which bears a remarkably close resemblance to that of a one-party political system.

The inherent vice, then, of all specifically delineated Utopias is that they embody their creator's ideal of perfection and that this could not be consonant with the ideals of other people unless all

and action may be stereotyped. So long as this is so the society will remain primitive.

<sup>4</sup> Houghton, Mifflin and Company, Boston, 1889.

people should be created in the image of the maker of the Utopia, or rather in the image of his (sublimated) image. Since such a creation is clearly impossible, even with a fantastic degree of arbitrarily selective breeding and "conditioning" of the population, "Utopias" are necessarily confined to a narrow elite to which the remainder of the population is entirely subservient.<sup>5</sup>

Such Utopias could not be social in any significant sense. In fact, the rule of an elite is the open road to the use of terror. A world of this type does not seem quite ideal, even to its "leaders," but the leaders are prone to regard the situation as merely temporary, to lay it to the "unreasonableness" or outright perversion of their recalcitrant subjects, and to call for an impossible "unity" (voluntary compliance) under which the necessity for terror would disappear.

It matters only in degree what the ideals of the oligarchs may be. A "city of God" would, with whatever differences, present disturbing analogies to a totalitarian metropolis. God's will must, unfortunately, be interpreted by alleged vicegerents who are all too human and are unlikely to be preeminent in humility. They are as slow as their less hieratical brethren to recognize that heaven, whether according to their own or any other conception, cannot be conferred upon men, but that each man must win it, if at all, for himself.

The best that we can do is to provide the fullest opportunity to the individual to work out his own salvation. For, though it is impossible to give men heaven, it is easy to give them hell. The surest means of avoiding the latter is acceptance of the principle of individual responsibility. We shall not by this means quickly move into a state of universally recognized millennial bliss but we shall at least not share the fate of the Gadarene swine.

Man's reach, we may hope, will always exceed his grasp, and heaven, therefore, even if we were all alike, is unattainable.<sup>6</sup> Men

<sup>5</sup> All the even faintly realistic Utopias, from Plato's *Republic* onward, provide for some such subservience.

<sup>6</sup> That is to say, a heaven on earth. Any posthumous heaven is presumably peopled by transformed creatures who have lost their mundane variabilities and have, in any event, no further aspirations.

The dreamers of a heaven on earth are, as Professor Reinhold Niebuhr likes to point out, divisible into two classes. There are the hard Utopians (represented by the Nazis) who are doers as well as dreamers, have persuaded themselves that they

must therefore pursue, rather than expect, happiness, and, rather than happiness, they might better follow some slightly less evanescent wills-o'-the-wisp.

Human goals lie vaguely on a distant horizon whose margin fades forever as we move. But it is of supreme importance that we move along the appropriate road. That road is rocky but we shall find no magic carpet which will avoid the necessity of our traveling it.

This book is based on the thesis that the road we must travel is the road of power-*cum*-freedom. The general locus of its subject is the vaguely defined area which is common to ethics, politics, and economics. The territory was once familiar ground but it has, in recent decades, been much neglected. Specialization in subjects of study has carried the day and been pressed to such extremes that the necessity for coordination has had few to serve it. This is peculiarly true in the field of applied economics. It is, perhaps, in that field that we have fallen farthest short of attainment of clearly desirable, and patently realizable, ends. This is in no small degree the outcome of the diversion, if not the perversion, of the effort of students of economic affairs.

Orthodox economic theory is in part a description of what is, or was, and in part a "purification" of the system it purports to describe. Economics has always been under suspicion as a "science," and the consequent defensive attempts on the part of its exponents to force their theory into rigid scientific forms has frustrated its application to the facts of life. Not only have postulates, which originally represented an approach to reality, been progressively

can give men heaven, and proceed to do so with fire and sword. There are, on the other hand, the soft Utopians, represented by flabby "intellectuals" who, thinking they are liberal, refuse to recognize and fight evil because, as they say, this has in the past done no good and from their heaven fighting must be banished. In other words, both are absolutists, the flabby liberals holding that unless evil could be absolutely eliminated there is no sense in trying to combat it at all. Because liberalism had been imperfectly developed the one group attacked it fiercely and the other looked on complacently at the reversion to the law of the jungle. Since both groups, as uncompromising absolutists, were certain to be disappointed, the result was that both fell into a cynicism in which, of course, they were joined by those without *any* ideals other than self-centered appreciation. While the search for absolutes is in general unavailing, a presumptive absolute is, nevertheless, in the field of morals, indispensable to purposive action. This presumptive absolute must be based on the authenticity of humanism. Man is otherwise on a raging sea without any real means of navigation.

"refined," and thereby made less real, but the persistent trend of economic institutions has been away from the forms for which the doctrines were, in the first place, cast. Economic theory and economic fact have been marching in opposite directions.<sup>7</sup> Theory has, at length, become so "scientific" and abstract as to intrigue the mathematicians who have taken delight in developing the concept of a kaleidoscopic and frictionless play of atomistic units in a complex and eternally unfolding equilibrium. The notion of equilibrium suggested equations; equations are prolific parents of their kind; and the game has gone on until the pages of the more esoteric economic journals have become a mass of hieroglyphics intelligible only to those who know the code. All the inconvenient freight of fact has been discarded by the more recondite practitioners until the "science" has come to move in a realm of pure abstraction useful for purposes of cerebration but of steadily declining practical importance.

The Institutional school arose in revolt from this technique, and even the later mathematical economists, recognizing the barrenness of their earlier method, have sought to enlarge their premises but have not succeeded in giving them greater reality. The Institutionalists deplore the deductive approach, but their own studies have, in the field of policy, proved as abortive as has orthodox theory, largely because they, in common with the orthodox neo-classical school, have sought to keep their discipline free of value judgments (*Wertfrei*).<sup>8</sup> Devoid of any, even a bad, unifying principle, they have been assiduously collecting facts without any teleological value. Their very effort to achieve an impossible objectivity has made their work jejune. This is even more true of the

<sup>7</sup> cf. J. M. Keynes in the introduction to D. H. Robertson's *Money* (Harcourt, Brace and Company, New York, 1929), p. v, where he says that the "Theory of Economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method rather than a doctrine, an apparatus of the mind, a technique of thinking, which helps its possessor to draw correct conclusions." But not, be it noted, with respect to policy. Keynes, moreover, in this passage, fails to distinguish economic theory from pure logic where it has been well said that we never know what we are talking about or whether what we are talking about is true, that is to say, that all purely logical statements are tautologies. The whole content of economic theory, if Keynes has given us a good definition, may be summed up in the phrase "tautological transformations."

<sup>8</sup> Despite his Olympian attitude this was not true of Veblen, but Veblen was father, rather than representative, of Institutionalism.

Historical school which has devoted enormous energy to a largely feckless research.

Much first-rate analytical skill and much scholarly industry has miscarried because the road to academic recognition lay in the refinement of traditional technique, or in assiduous dust-gathering, with little consideration of ultimate purpose. The means have been exalted over the end, and the neophyte, compelled to show his mastery of the technique, has quickly learned to love and practice it for its own sake.

This is not to deny the virtue, even the necessity, of abstract speculation or the desirability of the most catholic comprehension of the facts. It is merely to assert that these should be tools rather than ornaments and that we should never cease to ask ourselves what we want and how we propose to get it.

To the contentions of the enthusiasts for *Wertfreiheit* it must be conceded that a large objectivity is, of course, a necessary condition of scientific inquiry. This does not mean, however, that the scientist must be free from all emotion or from preference for any given set of ends. It may, indeed, be confidently asserted that perfect objectivity, in the sense of freedom from emotion and from more or less conscious judgments of the relative values of different ends, is impossible. Complete objectivity can be attributed only to materials and machines, but men are, inevitably, something more or less than these. Thinking is necessarily subjective and conditioned by non-rational impulses.

All rational activity, and therefore all scientific ratiocination and experimentation, is purposive; that is, such activity is guided by some preconceived end which the thinker uses as an arbitrary norm to determine what thoughts, actions, and data are relevant. In science, the only question which arises out of the problem of the selection of goals or ends is whether these aims are to spring from mere curiosity or from a desire to discover relationships which may be of value to preconceived purposes. Whatever be the source of choice which leads one scientist, apparently in a spirit of mere curiosity, to study economics, another physics, and still others mathematics, there can be no doubt that the decision to choose one field rather than another rests on a value judgment.

It makes no necessary difference to the pursuit of a scientific inquiry what ends are posited and whether they are posited by

some outside authority or are laid down by the seeker himself. In the latter case they are, of course, likely to correspond with inevitable emotional preferences which may distort the vision. It is on the probability that this is so that the case for so-called *Wertfreiheit* rests. But the proponent of *Wertfreiheit* is subject to a psychological quirk at least as likely to affect his judgment as are the predilections of the student frankly interested in the ends he seeks to realize. The person who believes himself entirely free of value judgments is a victim of self-delusion and, under the influence of unconscious bias, is perhaps more prone to error than the person who, conscious of his preference, is watchful that he does not indulge in wishful thinking.

The assertion that the scientist should be completely free of value judgments, even if it were realizable, is in itself, of course, a value judgment. There seems, moreover, to be no a priori reason for the contention that it is better to be cold than warm. On the contrary, a convincing case could be made for warm feelings and a cool choice of methods for their satisfaction. Science involves both analysis and synthesis and the synthesis must be purposive to some ulterior end. Science, and particularly social science, must be not only analytical but imaginative. The goal must be not exclusion of one or the other requirement but their maintenance in separate compartments of the mind so that they do not corrupt one another by miscegenation. Insistence on *Wertfreiheit*, therefore, boils down to nothing more than a caution against a refusal to face facts. About this there is no room for any controversy.

The great classical economists were not chary of choosing express or implied objectives nor, on this account, afraid of the charge of lack of scientific objectivity. The degree of governmental action or inaction which they favored, and indeed the whole body of their thought, was inspired by the desire and design to promote freedom, equity, and a rapidly progressive mastery of the physical basis of living. They knew that the conditions under which life, and work, is carried on are quite as important a part of the standard of living as the immediate return on such work as is performed and that no economic system can be satisfactory if it traverses the fundamental desires of the majority of its members.

The tradition of Adam Smith, and of John Stuart Mill, is more fruitful than that of the rigid and frigid Ricardo, however neces-



sary Ricardianism may be in preventing prejudiced, confused, or merely wishful thinking. Political economy, perhaps in contrast with "economics," is concerned not only with things as they are but with things as they could and ought to be. The latter implies either an acceptance of whatever is as right, and a mere explanation of the facts, or a set of predefined ends toward which the facts are, as far as possible, to be shaped. Mill was acutely conscious of the gap between the real and the ideal and was concerned, above all else, to narrow it, but, to his heirs in economic speculation, logical gymnastics have "offered an . . . intellectual retreat from a disillusioning contemplation of the march of events."<sup>9</sup> They therefore resigned the role of philosopher and took refuge in a neutrality under which, in place of inquiries into the wealth of nations, "we are . . . offered explanations of what will happen (once equilibrium has been finally reached) when we choose each of the several alternatives which are commonly thought available to that end."<sup>10</sup> The final retreat was into a sanctum sanctorum from which the dictum went forth that "economics" has nothing to do with the actual conduct of what is still (no doubt perversely) called economic life.

Slightly less impeccably objective writers have been content to affirm that science is concerned only with means and not with ends and that the final determination of ends must be left to those fitted to make value judgments, whoever *they* might be. Any technique of social control, however, involves human interests and the exercise of power over men. This means that any suggestion of a method for the solution of a social problem is shot through with normative implications. There can be no practical divorce, in social analysis, of means and ends when the results of such analyses are to be utilized in the attempt to effect any change in an existing situation. The only honest course, then, is the declaration of a scheme of social values as a basis for the development of suggestions with respect to social institutions.

The scheme of social values which appeals to the present writer is not new. It does not differ basically from that of classical liberalism. This study makes no claim to novelty in setting forth social

<sup>9</sup> A. S. J. Baster, *Advertising Reconsidered* (P. S. King and Son, Ltd., London, 1935), p. 83.

<sup>10</sup> *loc. cit.*

objectives; its function is rather to appraise the economic institutions which have evolved in allegedly democratic systems and to expound a coordinated program of institutional readjustments within the limits of the democratic ideal. Primary consideration will be given to the liberal tradition of free competition; to the institution of private property, with special reference to the significance of individual inheritance; to pecuniary institutions; to incentives to enterprise; and to problems of distribution.

In reliance upon the truth of the dictum that there is no folly like wisdom spun too fine, the discussion has been kept as simple as is consistent with other than a fumbling grasp of the essential facts and forces in the situation. It has seemed to me that, in the endeavor to comprehend the vast panorama of modern events and to secure some insight into the phenomena of social life, primary emphasis must be placed on power in its varied manifestations. In the words of Bertrand Russell the "laws of social dynamics are . . . only capable of being stated in terms of power. . . ."<sup>11</sup>

In adopting this approach it is not suggested that the problem of human motivation is exhausted by the category of power in any narrow sense of the word, that is, the inference should not necessarily be drawn that human incentives can be reduced to a single dimension. But to look at controllable phenomena in terms of power, broadly construed, nevertheless provides the best key to their understanding.<sup>12</sup>

A final word should be said about the practically complete reticence of this book on the subject of the phenomena of war. The reason is that, though war may, at times, be the sole means for the realization of social goals, or for the maintenance of the conditions under which alone they can be realized, it cannot in itself be a permanent social goal and can scarcely be classed as an economic institution. It might perhaps be granted that war is a terrible but necessary medicine for diseased mankind, but the exaltation of war as the true end of man is itself a disease which successful war could never cure—and, in spite of the fact that men learn much

<sup>11</sup> *Power* (W. W. Norton and Company, New York, 1938), p. 15.

<sup>12</sup> This is more or less fully true, of course, only of volitional activity. Many human actions are of the nature of involuntary responses to given stimuli. These probably reflect courses which, in a former environment, consciously or unconsciously promoted power or preservation. In many cases, however, they are now a survival which no longer has survival value and may even be suicidal.

more from defeat than from victory, no one has yet argued the virtue of *unsuccessful* war. *Social* goals can, by their very nature, be achieved only in a peace of general consent, within the area at least which, for the purpose in hand, constitutes the society. So far as it is necessary to wage war to establish or maintain the conditions under which progress toward social goals can alone be made, that progress is, for the time being, necessarily in abeyance.

The economic institutions appropriate to war are very different from those which are desirable when war, or the preparation for it, does not absorb all the energies of a social group. The economics (and the politics) of war are simple so far as ends are concerned. The whole purpose of a war effort is to maximize the power to destroy the enemy. This temporary social goal excludes all others, and everything else must, if necessary, be sacrificed to this one end. Where the only choice is fighting, or abject surrender, social goals cannot be selected. In the one case they are *prescribed* for the moment, in the other they are *proscribed* for good. War, not infrequently, results in advance toward ultimate social goals. But it is necessary, at the very least, to have *intervals* of peace for the consolidation of any such advance and for further steps forward. Peace is more complex than war since it permits of the pursuit of an infinite variety of aspirations, and a proliferation of the human spirit, impossible in war, where attention must be unflaggingly concentrated on a single purpose. It is, therefore, as a design for those interludes of peace, on which our hopes must dwell, that the ensuing program is presented.

## **PART I • SOCIAL GOALS**



## CHAPTER I

### THE NATURE AND POSSIBILITY OF SOCIAL GOALS

**T**HIS book is written in the perhaps too simple faith that man can shape his destiny. It would be futile otherwise to speak of social goals rather than of fate.

The importance of material factors in the determination of history has been grossly exaggerated. The spontaneous ideas of individuals, effective in part at least through sheer accident, have often turned the course of events into such wholly unexpected channels as to preclude the notion that the events were materialistically foreordained. It would, moreover, take a fanatical determinist to stick to the thesis that the trend of affairs is quite independent of the will of those who seem, at any time, to be its spearhead, and that every one of their actions is predetermined by forces and powers with which neither they themselves, nor any other men, have had any relation other than that of unconscious instruments.

The position here taken reopens, of course, the old controversy over predestination and free will, to say nothing of the role of accident. It will be enough, at this point, to state the writer's conviction not only that free will is in fact operative in human affairs but that the mental structure of men is incapable of supporting a thoroughgoing belief in predestination except under the illusion with the individual believer that he is cast for a great and, for him at least, beatific part in the drama of eternity; that what *he* wants is the will of God.

### ACTIVE ADAPTATION AND SURVIVAL

The influence of Darwin lent support to the fatalistic view of life and confirmed the notion that whatever is is "right." Yet it is in no absolute sense that one can speak of fitness for survival, nor is the standard of fitness anything but survival itself. Those men and institutions which manage to survive in a given environment are *ipso facto* "fit." This does not mean that the survivors are fit in any other sense (from the point of view of humanity as a whole they may be unspeakably vile) or that they would be fit at all should the environment be altered. A change in environment may make the fit unfit, and the unfit fit, the last first and the first last.

#### 4 SOCIAL GOALS AND ECONOMIC INSTITUTIONS

It is the peculiar trait of man that, in an infinite variety of ways, he seeks to adapt his environment to his will and, so far as he is successful, changes the conditions of survival. He himself can shift the incidence of the process of selection, can thus make fit those that were formerly unfit, and put a curse upon those that were formerly fit. No sub-human creature even remotely approximates man in this respect.

The whole sub-human creation characteristically accepts its environment as a datum which it can modify, if at all, only in the most limited and stereotyped fashion. Passive adaptation is here the condition of survival. But man's ability to mold his circumstances to accord more nearly with his heart's desire gives him the power, in greater or lesser measure, of selecting for survival that which seems good to him. He has so changed conditions for the sub-human creation that those species which serve his purposes now exist in numbers which would have been otherwise quite impossible, while many of the species which, without his intervention, would have bestridden the world, are in rapid process of extinction. Varieties, within a species, which would have had no survival value if they had not been relatively useful to man, have been selected, protected, and encouraged until they have become by far the predominant strain.

#### SOCIAL SELECTION

Man can do for himself what he has done with the "lower orders." It is well within his potentialities to establish the conditions under which a self-imposed selection, analogous to that which he has imposed upon the "lower orders," will make for the survival of socially preferred types of men and institutions. All social action accomplishes this, in some degree, and the essential social task is to give more precise direction to the process. This can be done, however, only so far as major social goals are clear and consistently pursued.

For, though it be granted that men are, at least in part, free agents, it does not follow that human, and particularly social, evolution will follow the course that men, as a whole, desire. Even if no informed person would now assert that human, and particularly social, evolution is solely conditioned by the appearance of those characteristics which would make for survival in a milieu of strug-

gle between individuals passively adapting themselves to an independently determined world, and even if few would deny that modifications of the environment through more or less capricious individual and collective action will change the conditions of survival, yet man may effect no "improvements" and his last state may well be worse than his first.

#### LIMITATIONS AND PERVERSIONS OF SOCIAL EVOLUTION

We must not be blithe in speaking of man's freedom and capacity to control his social destiny. History reveals no society which has gained a consciousness of the mechanics and dynamics of its institutions sufficient to prevent their operation to ends quite different from those for which they were devised and quite alien to any comprehensible purpose. This historic fact has in every age given rise to theories of institutional determinism, from the "cycle of civilization" of the ancient Greeks to the modern views of Marx and Veblen. The realistic position probably lies somewhere between the optimism of the eighteenth century political philosophers, to whom all social relationships, in a "state of nature," were rational and orderly, and the institutional fatalism of some of their successors. The kernel of truth in the "deterministic" view consists in the fact that to the degree that social man is not conscious of the institutional "forces" making for conflicts of power among individuals and groups, and is thereby rendered incapable of reconciling these conflicts through institutional change, he is indeed a victim of "forces beyond his control" and a child of fate. On the more optimistic side, however, it may be said that the so-called "institutional forces" have no existence independent of man and that the tyranny of institutions over men will cease as knowledge of social relationships grows and the resolution to adjust the conflicts that arise therein gains in intensity and effectiveness.

But, again, history gives no warrant for sentimental optimism concerning the ease with which social knowledge is to be attained, much less the social consciousness and motivation to make effective such knowledge as is at hand. Every period has had its sages, but they have seldom been recognized as such by their contemporaries, to say nothing of attaining sovereignty. The circle of interests of the average man is tragically narrow and the drift of



institutional events is beyond his ken. Thus he ignores the larger world except when, from time to time, it ruthlessly interrupts the normal pattern of his life, and then, of course, it is usually too late for him to stem the sweeping current of events. Society will always have to rely on enlightened minorities both for its watchdogs and for its constructive innovators, and the possibility of genuine social goals, such as are here envisaged, requires a much greater degree of social consciousness in furthering their efforts at social amelioration than has ever yet been attained. This can come only as the conviction develops among a large number of reasonably intelligent and highly resolute individuals that the failure to take a strong social attitude is fraught with danger to themselves. All action begins with an individual but, even when it is in the social interest, it is retarded in the degree in which cooperation is necessary, and must be cajoled, and it is in persistent process of diversion to anti-social purposes. This is why the Bible of the race is slowly writ. That part of progress which is solely dependent upon individual action has been rapid but, in social affairs, the advance has been sluggish and marked with the most violent vicissitudes. It is for this reason that it is desirable, so far as at all possible, to harness the individual's pursuit of his own interest to the social chariot.

Not only is the mass of men inert in social affairs but powerful *individuals* are always seeking to establish the environment under which the kind of human animal that only they prefer will flourish. To do so they employ arbitrary, that is anti-social, power, and effect a measurable approach to the horrible condition which Mr. Aldous Huxley has ironically pictured in his *Brave New World*.<sup>1</sup>

The power to use contains the power to abuse and, though it is at least conceivable that society can establish the conditions under which that type of individual will survive which intelligent man, in his collective capacity, favors, it is perhaps more likely that the collective will may never at all come to adequate and faithful expression.

#### THE HUMANISTIC CREED

The phrase "collective will" raises the question as to whether men really have any common, that is social, ideas, interests, and

<sup>1</sup> Doubleday, Doran and Company, Garden City, New York, 1932.

aspirations. If they have not, there can be no collective will and social goals become an impossible concept. Some agreement on values, an ethical norm, is indispensable as a basis for selection, as an independent determinant of what is fit, and as a touchstone of men's striving. The great requirement is some universal creed around which, as a standard, all men can rally.

The nearest thing to such a creed, so near as to make the exceptions negligible, may be found in the following articles:

1. *The world was made for man.* This notion is, in all likelihood, a mere reflection of human egotism, an arrogant and improbable assumption, a myth. It is, however, a necessary myth, involved in all human action and, since man has in any event appropriated the world to his own uses, it has moved from the category of pure myth into that of axiom or irrebuttable presumption. The idea of the "rightness" of the domination by man of the sub-human world, and of the molding of it to his will, is seldom argued since it is, like all creeds, irrational, but, unlike most, is of practically universal acceptance. It is so deep-rooted, so associated with the instinct of self-preservation, that we cannot think of anyone who does not share it as other than insane, though he might, in fact, be merely objective or "scientific." Those creatures naturally adapted to almost any environment (land, water, or air) such as, for instance, loons, might well, on purely objective grounds, be preferred over humankind. "Pure science" might at any time have required the elimination of man in their behalf. But it may be assumed that no man would follow his logic quite so far. The clean-cut division in thought between mankind and all the remainder of creation, with the remainder increasingly subordinate to man, is then the most solid ground on which social goals may rest.

2. *Power is "good."* The progressive mastery by mankind not only of the "lower orders" of animate creation but of the earth, sea, and sky, demands increasing power. Though the abuses of power have led to the dictum that power is poison, men are at heart convinced of the contrary and think of power as the breath of life and even as life itself.

3. *Coercion is "bad."* This conviction is a corollary, the obverse, of the sentiment that power is good and, like it, is an essential part of the anthropocratic idea. The coercion of one man by another, the making of him the unconsenting tool of the latter's purposes,

is to reduce the coerced to the status of human livestock and to blur or blot out that distinction between man and brute which is the first article of the universal creed.<sup>2</sup>

#### POWER AND ETHICS

Much has been written of good and evil and much has been disputed until, in a hopeless mental fog, we wander in the wilderness of ethical relativity where there is no light, no hope, no standard.<sup>3</sup> The only solution lies in a sharp dichotomy between humanity, *as a whole*, and all the rest of creation. If we make a list of those human attributes which have ever been regarded as virtues, we shall find that they group themselves into two categories associated with power. There are, first, the self-regarding, or self-reliant, virtues, those which would be specially useful to man as a means of promoting his power over the non-human world in isolation from his fellows. Among these virtues are physical vigor, mental alertness (including invention, observation, curiosity, and cunning), tenacity of purpose, manual skill, courage, industry, sobriety, cheerfulness, foresightedness, thrift, and general mastery of the appetite for immediate self-indulgence. The correlative vices, or sins, are physical flabbiness, stupidity, dissipation, clumsiness, cowardice, sloth, frivolity, gloom, improvidence, prodigality, and general incontinence.

The second category of virtues, the social virtues, are those which inhibit the use of human power in the coercion of other men. These virtues include honesty, equity, sympathy, generosity, grace, benevolence, beneficence, and magnanimity. The correlative vices, all of which involve an invasion of the freedom of other men, are violence, guile, mendacity, subreption, cruelty, greed, ruthlessness, envy, jealousy, covetousness, lust, malevolence, and selfish anger. None of the actions covered by these latter terms are thought to be reprehensible when brought to bear against the non-human world unless they are at the same time alleged to injure

<sup>2</sup> There is no possibility, for instance, of getting general agreement on the proposition that the world was made for Nordics, or even "Aryans."

<sup>3</sup> Adults unable to distinguish between right and wrong are held by the law to be imbecile; but this is the unhappy mental state of many professors of ethics. cf. *Ethical Relativity*, Edward Westermarck (Kegan Paul, Trench, Trubner and Company, Ltd., London, 1932), *passim*.

some other human being—psychologically or otherwise—or, in some fundamental way, the actor himself.

The social virtues cover both the qualities generally regarded as duties and those which rise above that category into that of graces or sublimity. This is because the weakness of man lies not in excess of sympathy but in excessive selfishness. Because man is constantly tempted to exert his power over other men it is necessary to insist upon more than mere uprightness so that the deficiencies in many men always, and in all at times, may be compensated by something more than mere impeccability in other men and on other occasions. If all men performed their duties fully there would be small need or place among them for the more generous virtues, but, since they do not, we can ill afford to dispense with such emollients to men's vices as we can anyhow develop.

Some philosophies accent the self-regarding and some the social virtues, and their contradictions issue from the relative emphasis on the one group or the other. The fact is that both groups are of equal importance, and both must be realized together, though of the social virtues it is the duties only, not the graces, that are *essential*. It is worthy of note that practically all codes of ethics, from that of Nietzsche, which lays stress upon the self-regarding virtues, to that of Christ, which insists upon the social, turn on power as a pivot. This is obviously true of Nietzsche but Christ's saying "I am come that they might have life, and that they might have it more abundantly" is equally concerned with power, since life can be more abundant only so far as it becomes more sentient, cognitive, creative, and in many other ways attains access of power.<sup>4</sup>

<sup>4</sup> Nietzsche was perhaps no more one-sided than Christ though the supply of the social is so much shorter than the supply of the self-regarding virtues that Nietzsche's bias is obvious and, in his neglect of the social virtues, horrible, while Christ's is hidden and appealing. But the passage in which Christ asks for approving contemplation of the lilies, which neither toil nor spin but are arrayed in glory, and the incident in which Mary was praised and Martha rebuked, show a somewhat excessive disregard of the self-regarding virtues. The power to exercise social graces in any effective way can arise only from a prior development of the self-regarding virtues and the acquisition of the fruits thereof. There is no possibility, therefore, of perfect selflessness. Selflessness, moreover, may become a social vice rather than a virtue. If the world were all but universally comprised of sentimental

Even those codes of ethics which reach the limit of abnegation—the Nirvana group—seek mastery for men though in a negative, a defensive, way. They would make man if not the conqueror of, at least unconquerable by, his environment. This is not so much passive adaptation to circumstance as it is a rising of man above it. There is no irreconcilability between those who thus seek indifference to circumstance and those who seek a positive mastery over it. Let each go his way unmolested, each has his contribution to make, the preeminent social goal involves no narrow uniformity but a harmony of infinite variety of tone. The basis for such harmony is no more, nor less, than the recognition that the power and freedom that is good for each is good for all.

#### THE ESSENCE OF SOCIAL GOALS

It might be possible to discover other more or less universal values, but those of human power and freedom are enough with which to write the code of social action. The more detailed the categories the less pervasive will they be. The less pervasive they are the less can they be truly social and the less solid the structure which may be built upon them.

The essence of social goals is the release and enlargement of the power of men as a whole. More specific ends are but aspects of this larger purpose. We may know, darkly, what men are, but we know not what they may become. Man cannot, therefore, without treason to his birthright, select his own kind, as he selects the lower orders of creation, for such specific, narrow, and evanescent ends as are not engrossed within the larger purpose. But, if he establishes the conditions under which those of constructive power, rather than those who are merely predatory or parasitical on their fellows, can not only survive but flourish, human power as a whole

altruists it would be handed over completely to the then few remaining human tigers. No social goals can be attained without a lively regard of the individual for his own interest. The sole condition is the recognition of the equal claims of others. The Christian ethic, as ordinarily interpreted, offers no solution to social problems. The non-militant Christian may bind up the wounds of sufferers from man's inhumanity to man, but any approach to an impossible simultaneous universality of altruism would merely lead to a multiplication of the wounds. This is not to deny the immense importance of Christian graces as an emollient of frictions but it is to deny their efficacy as a cure for social ills.

will steadily advance.<sup>5</sup> All of those goals which can, in any sense, be social, will then be in process of consummation and man will then be shaping his fate according to his will.

<sup>5</sup> The words "constructive" and "predatory" involve, of course, the assumption of the "rightfulness" of the mastery of nature by man. Constructive action, from the human point of view, will ordinarily be predatory upon the "lower" orders as, for instance, in the search for animal food, in vivisection of animals in the conquest of human disease, and the like.

## CHAPTER II

### *POWER, FREEDOM, AND THEIR COROLLARIES*

#### PROMISCUITY OF POWER

**P**OWER, the generic term which all but completely covers human aspirations, takes protean forms and frequently expresses itself through its apparent opposite. A Uriah Heep may grasp for power under a mask of mock humility, and many less sinister men seek a similar modicum of might through deference. The transformation from fawning to tyranny, and vice versa, which is so often a feature of a change of status, is readily explicable in that either attitude seems, to the individual concerned, appropriate in the circumstances to the attainment or exercise of power.

Men of a generous stamp may seek to be the greatest among their fellows by being the servant of all. Their search for power is then sublimated but is not obscured since to be the greatest among one's fellows is, in some sense at least, to be the most powerful. The common attribute of saints and sinners is a thirst for power, and the possibilities of both saintliness and sin hang upon the power which the practitioners of either can command.

Power is both a means to the attainment of any end and an end in itself. Every individual is the center of his world and to few is that world completely satisfactory. To even those few the power to prevent, and to all others the power to effect, a change in the environment is sought. Men desire to have power, to exert it, to have it recognized, to guard it, and to enjoy its fruits according to their will. These several aspirations account for much of the seeming inconsistencies in human conduct. The same man will be venturesome or timid according as he seeks new power or is fearful of losing what he has; he will show a desire for distinction (the recognition of power of some sort) and also a desire to conform (fear of loss of power); he may enjoy the presence of danger (frequently issuing out of a struggle for power) but only if he feels that he can master any threat to his own power that it may convey. Radicals become conservative, and conservatives radical, after a shift in power occurs, and all successful revolutions seek to put a stop to the spirit of revolt, that is, the desire to effect a further shift of power.

Just as the same man at different times so will different men at the same time show varying characteristics according as they are predominantly avid for increased power or apprehensive about a threat to that which they already have. The more power a man has the more concerned will he be over losing it. This will impel him to expand his power as insurance of his current status but not to take much risk in doing so. The less power a man has, on the other hand, the greater the likelihood that he will be disposed to take the risk of its loss in an endeavor to increase it. This, as will later appear, has an important bearing on economic institutions.

The desire for power is the dominant force behind the so-called "instinct for workmanship," the search for efficiency in the molding of the environment to accord more nearly with the wish of the individual concerned. The desire for recognition of power, on the other hand, is at the bottom of the tendency toward conspicuous display, waste, and what, on any other ground, must be regarded as ineffective action.

The craving for recognition of power is indeed so strong that many men are content with deference from others though there be not the slightest warrant for it. This is not so much because deference may give them the fruits of a power which is not inherent in them as because the shadow of power is to them a satisfactory substitute for the substance. It is a rarely noble individual who is more concerned to deserve praise than to receive it, and even he is perhaps not unmoved by desire for the approval of those maybe mythical heroes whom he has made the sovereigns of his soul. The desire for power is thus quite as frequently attributable to an eagerness for the (sometimes hypothetical) respect of others as it is for any material satisfactions that power can convey.

As power is coveted for immaterial ends so it is frequently exerted for no other purpose than to demonstrate its presence. The character of the motives impelling men to seek power, and the strength of the passion for power in general, vary greatly from man to man, but there are, nevertheless, few voluntary human actions for which it is not the criterion.<sup>1</sup>

<sup>1</sup> "So that in the first place I put for a general inclination of all mankind a perpetual and restless desire of power after power, that ceaseth only in death." Thomas Hobbes, *Leviathan* (Edition of George Routledge and Sons, Ltd., London, 1907), chap. xi, p. 61.



## THE HIERARCHY OF POWER

The quality of power is measured along a scale moving away from the types which predominantly mark the brute creation. Mature men think of intellectual and artistic power as inherently superior to physical strength, agility, or "low" cunning, and of moral power (self-discipline) as perhaps the highest form of all. Mental and moral strength are the distinctive types of human power. These maturer forms of power are, however, much less hardy than the primitive. They do not come as readily to birth and they are less viable when born. They require a sheltered environment whereas the more primitive forms thrive on risk. The sheltered environment, in which alone the more mature forms of power can develop, can be established only through the prior exercise of the more primitive forms, but the more primitive, though an essential base for the development of the more mature forms, are frequently, and not without reason, hostile to them. There is the danger that the environment in which alone the maturer powers can develop may result in the atrophy of those more primitive powers on which everything, in the last analysis, depends. The task of civil organization is to provide the conditions under which all forms of power may come as fully as possible to coincident, and sustained, fruition. This is a matter of the development of varied types of power, of the prevention of their predatory use, and of the safeguarding of any form of power against atrophy. It requires the maximization of the power of individuals within a social scheme.

## POSITIVE AND RELATIVE POWER

Power may be positive or merely relative. To an isolated man, power and freedom are identical terms. There can be no freedom without power, since freedom is nothing but the possession of such power as is adequate to overcome inhibitions on the realization of the possessor's will. Where such power is present there is the possessor free; where it is lacking, he is bound. But, though freedom in any individual case is proportionate to the net power possessed by the individual in question, it does not follow, of course, that every access of individual power increases the sum of power and of freedom. For it is open to any individual to increase his own power (and freedom) by the subjection of other men to his will.

to acquire relative rather than positive power. Such power is not necessarily used in predatory ways but it is, in fact, seldom used otherwise. The processes of gilding the lily and gelding the lowly have always gone hand in hand and, so long as either survives, always will. Positive power tends to decline thereunder since the gilded lily will quickly wither and the gelded lowly are progressively deprived of the ability to generate power. Social ends can therefore be served only by so wide a diffusion of power as will prevent exploitation and insure freedom. Freedom has never developed except on the basis of a balance of powers.<sup>2</sup> Power must, of course, be concentrable to specific purposes but, if social goals are to be realized, it must be concentrated, when necessary, as nearly as possible on a basis of general consent.

#### POSITIVE POWER AND JUSTICE

Consent is possible only through justice. What is just, however, presents a question quite as perplexing as the query "what is truth?" There are few sayings more apt than that "most people who are clamoring for justice are fortunate if they do not get it." When justice has been defined in terms all the way from "the interest of the stronger" to "the harmony of the *corpus mysticum* encompassing the earth and the heavens"—with less extreme definitions showing the metaphysical quality of the latter of these rather than the precision of the former—a certain vagueness as to the content of the concept is apparent.

#### JUSTICE AND EQUALITY

Though the idea of some kind of equality as essential to the concept of justice persistently recurs, the question as to what is just is then merely transformed into "what is equal?"<sup>3</sup> Is it equal or "fair" that men of differing power in a contest—let us say for purposes of illustration a footrace—should start from the same line rather than under handicaps in presumptive correspondence with their ability? The latter course, though frequently adopted, seems fundamentally absurd, since, if the handicaps are appropriate, a

<sup>2</sup> cf. Lord Acton, *The History of Freedom and Other Essays* (Macmillan and Company, Ltd., London, 1909), *passim*.

<sup>3</sup> cf. T. N. Carver, *Essays in Social Justice* (Harvard University Press, Cambridge, 1915), *passim*.

decision in the race would be the result of purely fortuitous circumstance. If, on the other hand, no mischance occurs in the running, any decision will reflect only the incompetence or corruption of those by whom the handicaps were laid down. Patently it is none of these ends which is sought.

A handicap race may be intended, of course, to bring out "talent," by encouraging the slower runners to enter the contest, or it may be intended merely to provide a close finish with which to regale the spectators. Such races, however, are frequently held without either of these intents but because, in one aspect at least, handicaps seem "fair." A contest of this type might have as its slogan "from each according to his powers; to each according to his needs." The notion is that equity is served when equality is the final outcome and that competence should be compensated by obstructions. Yet no attempt is made to conduct championship games on this principle, though it is these games, rather than handicap contests, that are the nearer epitome of life.

Competition is the law of life, manifold and in some form all but ubiquitous. The attempts to suppress it or nullify its results are hopeless crotchets in violation of the fundamental nature not only of man but of all living things. Competition has evil effects, moreover, only when it is conducted on a primitive level—or when, though on an advanced level, it is but partial. It is not the fact but the form of competition that must be watched.

No runner would ever be content to engage only in perfectly gauged handicap races (which must, except for luck, result in a general "tie") unless he should accept, as recognition of his prowess, the size of the handicap imposed upon him. This he might perhaps do in the knowledge that people would come to look not to the end of the race but to its beginning!

No man, similarly, could ever be satisfied with a life in which recognition of his powers, in the form pleasant to him, is persistently and consciously denied. Recognition indeed, in some form, even if it be obstruction, *cannot* but be given, and it is clearly perverse to give it in the form of obstruction in all cases in which men's powers are exerted to socially innocuous ends. Rather should society contrive the means of giving to all individuals whose activities promote the general welfare the various types of recognition that each may crave. This would, no doubt, give relatively high

material rewards to those who are merely philistine in character, but why not? Men of finer mold would not thereby be deprived of anything that they desire. All would, indeed, share in the material output of society in proportion to their desires for material reward and their power to command a general current recognition. Differential powers cannot be expressed at all except in terms of inequality of some sort of return.

#### DESERT AND CHOICE

The great benefactors of mankind can never be adequately paid in any material way, but they do not desire such payment. Men who prefer the recognition of posterity over the more tangible rewards available in the present, and men who cherish above all else the acclaim (sometimes merely presumptive) of some hero, deity, or esoteric group, will have no reason to complain of inequity if they fail to receive the reward they spurn even if their success in attaining the prize they covet is dubious. The higher prizes, whether corporeal or not, are riskily reached if they are to be attained at all. He who seeks them assumes, as a necessary condition, the probability of failure and can blame only the lack of purity in his motives, his own bungling, or his naïveté, if he is dissatisfied with the result.

To the immature and envious mind it may seem unfair that individuals already highly endowed by nature for any given field of endeavor should have their good fortune crowned by rewards, of whatever sort, commensurate with their endowment. Is not, it will be asked, the endowment itself enough? Why should rewards be added unto it? The answer is that many, if not all, types of differential reward in correspondence with natural endowment can be withheld only at the cost of effectually stifling the exercise of great and beneficent talents. To withhold them would, it may be guessed, be the annihilation of that *harmony of the whole* which Plato and other philosophers have felt to be the essence of justice. To adopt as a general principle the idea of rewards other than on the basis of desert would, moreover, deliver the world to parasites who would quickly drain it of its blood.

It is only sub-average individuals who would want a dead equality of income. The inequalities existing now or at any time in the past are atrocious from the point of view of equity, but the infer-

ence that a complete leveling would be ideal is quite without foundation. Whatever the magnanimity of some, the lesser, the hireable, the rather unconscious or unpremeditating benefactors of mankind require the perhaps invidious stimulus of material discrimination in wages worthy of their work. There is, in any case, no hope in putting the loafer, the profligate, and the fool on the same economic plane with the industrious, the thrifty, and the shrewd. This would certainly result in a derogation from the general power and freedom and in irremediable social retrogression.

#### EQUALITY OF OPPORTUNITY

It seems clear, then, that the idea of equality involved in justice is the equality of opportunity—an open road to talent. Institutions, customs, and prejudices which confer on some members of society special privileges quite unassociated with inherent powers, socially exercised, are obviously in the road and to be removed. This is true whether the special privileges accrue to those who, as individuals, are inherently strong or to those who, as individuals, are inherently weak. The equality of opportunity involves an inequality of reward in strict correspondence with desert, the expression of individual power in such form as to enhance the sum of social power.

It is true that, if all special privilege were removed, rewards of any type would still vary in accordance with luck. In a world which must in large measure remain uncertain, since the future cannot be accurately foreseen by even the most active and profound intelligence, fortune must play a role. Insurance may spread the incidence of chance and, so far as returns are material, windfall gains might be taxed away and windfall losses made up to any individual on whom they might fall. This could, however, not be done with immaterial returns; and to separate the rewards of luck from those of merit is, in most cases, an impossible task. Pure luck, however, is irrelevant to justice in any construable meaning of that word. Equity or inequity can be the result only of an act of human will (which may or may not have been taken with the intent to realize the consequences which in fact followed upon it) and human justice is not involved in events which may properly be designated, in the legal phrase, "acts of God." Any alleviation of the burden on individuals of acts of God is a matter of charity, grace, or expediency rather than of justice, and there are, of course, some

types of burden which cannot be alleviated, in any substantial measure, at all. Such must simply be endured as part of the inevitable tragic element in life.

If the sort of equality of which equity is made is the equality of opportunity, the only appropriate limitation, on grounds of equity, of the free exercise by each individual of the talents he possesses, is that in which equality of opportunity would else be infringed in the process. The differences of reward that arise from the free exertion of unequal powers tend, of course, to place the superior competitors in a progressively better position and so, in a sense, impair the current equality of opportunity to men who started equal in that respect. The contest, however, must be assumed to be continuous, for any man, from birth till death. From birth till death but no farther. All power tends to be cumulative and, in the process of concentration, to lower not only the relative but also the absolute status of all but the centripetal holders. The cumulative development of any nucleus of power is, of course, often compensated by a cumulative development of resistance (opposing power). This may result in mutual frustration (inability to use power), in fighting (dual waste of power), in a merger to exploit third parties,<sup>4</sup> or in the defeat of one or the other concentration (loss of freedom). Freedom demands power but, if social freedom is to be attained, private or class power must by social action be given a positive centrifugal tendency to counteract the natural trend in the opposite direction.

This means that power may not appropriately pass from dead men to followers of their own choosing. While egalitarianism in the ownership and control of property is a denial of freedom,<sup>5</sup> the continuous concentration of the power of property from one generation to another is likely to result in the complete extinction of freedom. It is, in any case, a deviation from the principle of equality of opportunity. Even a merely relative decline in the property and consequent power possessed by the generality of men, without any decline in their modal absolute status, will forecast, or encom-

<sup>4</sup> This is expressed in the cynical political maxim, "if you can't beat 'em, join 'em."

<sup>5</sup> cf. Alexis de Tocqueville, *Democracy in America*, translated by Henry Reeve and revised by Francis Bowen (Century, New York, 1898), *passim*. De Tocqueville was greatly concerned over the tendency of egalitarianism to throttle freedom.

pass, a loss of freedom. This follows from the fact that the greater the spread in relative power the greater is the opportunity to acquire more power in socially noxious ways.

Mortmain is as reprehensible as, and frequently far more effective than, violence in the destruction of freedom. Institutional power must therefore be kept fluid, in constant movement from those whose grasp is becoming nerveless, if not relaxed, toward those who are capable of making beneficial use of power. Mobility, not status, must be the guiding principle.

#### ASSUMPTION OF RESPONSIBILITY AS A REQUISITE TO FREEDOM

Power and freedom can be reconciled through equality of opportunity only as between those who, given such equality, are willing and able to take responsibility for their own lives and actions, are determined that no one else shall presume to take such responsibility in their behalf, and will refrain from pretending to assume it for those who would prefer to take it upon their own shoulders. This means that the consequences of the actions of each, whether those consequences are good or bad, shall accrue, as nearly as may be, exclusively to him, or that they shall at any rate not be *imposed* upon other men.

Children and persons of unsound mind are clearly incapable of assuming responsibility for their own lives and actions and can have, therefore, no prescriptive claim to freedom. Criminals who perhaps could, but will not, take exclusively upon themselves the consequences of their actions must also be deprived of freedom if anyone else is to have it. It is only those who are sufficiently mature, mentally and morally, to be ready to take and to demand responsibility for themselves who can cooperate in the realization of social goals. The assumption of responsibility, and obligations, is a condition of any warranted freedom.

Social action implies comradeship among *socii*, that is, association among men none of whom presumes to assert any involuntarily conceded power over his fellows. All other inter-individual action is not social but tyrannous. Tyranny, whether benevolent or otherwise, can be eliminated only as between those who are equal in the sense of (1) standing on their own feet, (2) stepping on those of no one else, (3) removing those who step on theirs, and (4) cooperating as equals to these ends. Freedom of the individual

is thus of the essence of social action. Social action can, indeed, be exclusively defined in terms of the collateral enlargement of individual freedom.

No widespread individual freedom can, in a crowded environment, be secured by any other than social, that is, voluntarily co-operative, action. Even then it will necessarily be confined to those who are willing to cooperate to establish it. It is unique, however, in being indefinitely expansible to all who will adhere to certain simple principles. Yet it can be maintained only by those who partake of the wisdom of the serpent and, toward those who would violate the principles on which it is based, by no means the harmlessness of the dove. Self-reliant people must join with one another to the degree necessary to permit each of them to exert his just powers in freedom, must jointly and severally assume the obligations of such an association, and unhesitatingly thwart those who will not accept such a scheme of things. A group committed to the principles of social action cannot afford to deal gently with those who present a menacing challenge to those principles. Freedom, moreover, has many facets and it is all too easy to sacrifice one form of freedom in an attempt to attain another. Political freedom, for instance, may be jettisoned in an effort to obtain freedom from want, which is a form of freedom from fear. Freedom, however, though it has many forms, is fundamentally indivisible and the sacrifice of any part of it is the sacrifice of all.

#### SOCIALLY LEGITIMATE TYPES OF POWER

The correlation of action and the consequences thereof requires that, as between potential participants in freedom, power shall be exerted in no way other than through work of hand or brain, in abstinence from immediate indulgence, or in free contract and fair persuasion. Contracts can be free and persuasion fair only so far as force, fear, fraud, or the exploitation of ignorance, weakness, and distress, are absent. Since access to natural resources, or some equivalent thereof, can be denied to no man without depriving him not only of the power to contract but also of any means of sustaining an independent life, it is essential that such access be free. Justice, of course, requires that this access be not only free but equal.



Free and equal access to knowledge is as important as free and equal access to natural resources. If either is denied, the essence of free contract and fair persuasion disappears, and with it the possibility of any truly social scheme. Most tyrannies have been built on superstition of one sort or another. Enslavement of the mind is not only the easiest means to enslavement of the body but enables the tyrant in large part to refrain from exerting himself to enslave the bodies of his subjects. Free and equal opportunity for education and inquiry is thus a *sine qua non* of social freedom.<sup>6</sup>

<sup>6</sup> This is the irrefutable argument for state education. In no state, however, has the provision of education been carried to its logical conclusion which is that no one, in preparation for his productive life, be denied the opportunity of any education which he could turn to better account than some of those who are currently receiving it. No well organized state would suffer any socially useful talents to remain undeveloped by reason of the lack, in the possessor or his parents, of the resources necessary for schooling. Specifically, the school records of all children should be carefully combed in the effort to unearth talent, and the highest education, including keep, should be furnished as a matter of course to poor boys and girls who had shown that they possessed it. In the words of President Conant of Harvard (reported in *New York Times*, July 20, 1941, section 7, p. 23) the "privilege" of higher education should be abolished and it "would be a hardy soul indeed who would be willing to say . . . that there should be one type of education for the rich, another for the poor."

Consider also Alfred Marshall's statement (*Principles of Economics*, 8th edition, Macmillan and Company, Ltd., London, 1936, pp. 212-13): "The laws which govern the birth of genius are inscrutable. It is probable that the percentage of children of the working classes who are endowed with natural abilities of the highest order is not so great as that of the children of people who have attained or have inherited a higher position in society. But since the manual labour classes are four or five times as numerous as all other classes put together, it is not unlikely that more than half the best natural genius that is born into the country belongs to them; and of this a great part is fruitless for want of opportunity. There is no extravagance more prejudicial to the growth of national wealth than that wasteful negligence which allows genius that happens to be born of lowly parentage to expend itself in lowly work. No change would conduce so much to a rapid increase of material wealth as an improvement in our schools, and especially those of the middle grades, provided it be combined with an extensive system of scholarships, which will enable the clever son of a working man to rise gradually from school to school till he has the best theoretical and practical education which the age can give.

"To the abilities of children of the working classes may be ascribed the greater part of the success of the free towns in the Middle Ages and of Scotland in recent times. Even within England itself there is a lesson of the same kind to be learnt: progress is most rapid in those parts of the country in which the greatest proportion of the leaders of industry are the sons of working men. For instance, the beginning of the manufacturing era found social distinctions more closely marked and more firmly established in the South than in the North of England. In the

The reconciliation of power and freedom, in equality of opportunity for every individual prepared to accept the code of individual responsibility, is the essential basis for the realization of social goals and would be not far from their consummation. This will appear more clearly on a consideration of some more specific social objectives.

#### SECURITY

Much stress has of late been laid upon security as the human *summum bonum*. It is clear that, to realize their aspirations, men must avoid the slavery of fear. A crippling fear will, however, force its way into all but the noblest minds when experience has taught, and imagination pictures, the imminence of disaster without hope of escape. A large measure of security, an assured base of operations, is thus a condition of the conquest of the yet uncertain and unknown. The record of human progress, such as it is, is the story of the reduction of avertible uncertainty as a means of release of power. But, paradoxically perhaps, the search for security entails risk. So far as security permits an expansion of power it is "good"; so far, however, as it induces stagnation it must be damned. Man must avoid not only the evils of the jungle but also those of Lotus Land.

This means, in the economic sphere, that foresight, thrift, and self-discipline must ordinarily be attended by a proportionate reward of security so that those who practice these economic virtues may proceed on a well-founded conviction that, after years of industry and thrifty self-sacrifice, they will not find themselves no better off than the profligate, but it also means that courage in risky enterprise must not be persistently mocked or rewarded in wholly arbitrary fashion. The economically most worthy citizen does not insist upon, desire, and in any case cannot get, absolute security, but he craves such assurance against chaos as will give some meaning to the exercise of an essentially human and civilized

South something of a spirit of caste has held back the working men and the sons of working men from rising to posts of command; and the old established families have been wanting in that elasticity and freshness of mind which no social advantages can supply, and which comes only from natural gifts. This spirit of caste, and this deficiency of new blood among the leaders of industry, have mutually sustained one another; and there are not a few towns in the South of England whose decadence within living memory can be traced in a great measure to this cause."

prevision and will offer to courage some advantages over pusillanimity.

There can, of course, be no complete security against the vicissitudes of time and circumstance. Ours always has been and always will be an uncertain world. Absolute security is synonymous with death, whether death be merely a sinking into the waters of Lethe or an entry into the intolerable tedium of a riskless Heaven. Absolute security, in short, would lead to the degeneration of all that we think noble, that is, in any ideal sense, human.

The quest for security, nevertheless, is endless. Without freedom from the arbitrary exertion of power, or from the despotic sway of circumstance, there can be no security beyond that of the stockpen. The alleged assumption by arbitrary rulers of the responsibility for a whole people is an obvious fraud since the consequences of the decisions of the rulers must fall on the people as a whole while the leaders frequently make good their escape. Freedom involves risk but so does slavery. Ignorance, moreover, seldom confers any lasting bliss.

#### POWER, FREEDOM, AND ENTERPRISE

The highest expression of freedom in the economic world lies in a volitional assumption of the responsibility and risk associated with enterprise. Though we might greatly reduce its capriciousness, we can neither eliminate this risk nor, except at the cost of inducing stagnation, lower it beyond a certain point. The security we seek as a social goal must therefore be partial only, both in a qualitative and in a quantitative way. The test is whether any given security will enlarge or restrict the general power and freedom. To maximize power and freedom certain types of security may be general with other types optional. Those whose will to be secure is strong will then select an assured but modest living which would not appeal to the more active and daring members of society. It is on the latter that progress chiefly rests. Society can deny them such incentives as will educe their powers only at its own great peril. It must, at any cost, keep enterprise high.

On the basis of power as a criterion men may be separated into two great, if not sharply defined, classes of very unequal size. The motives of individuals within either group are mixed, but the larger group is more or less content with merely enough power to

insure comfort to themselves and their dependents. Their standard of comfort may steadily rise as certain hitherto unfulfilled aspirations are satisfied. This requires a steady access of power. The disposition of the group, on the whole, is nevertheless quietist in character, provided its modest claims are not persistently frustrated. Persons in this group may be willing to place their fate in the hands of others so long as their aspirations are thereby realized more fully than would otherwise be the case, but they would always wish, consciously or unconsciously, to retain the power to escape at will from direction. The "father complex" is never quite complete.

The smaller group, on the other hand, is composed of ambitious men who, to a much greater extent, love power for its own sake. The forms of power these men desire may be subtly determined by the ends they feel they have the chance to realize. The masterful individuals in this group may be either the glory or the curse of humankind according as their will to mastery is directed against the non-human world or against their fellows.

The manifestations of the masterful spirit are likely to take predominantly noxious forms whenever the conquest of the non-human world, for any reason, lags. If there is a practically unpeopled continent to subdue, masterful men are much less likely than otherwise to turn to unalloyedly predatory pursuits. When, however, the further conquest of nature requires chiefly the subtler forms of power—those, for instance, of the laboratory and the study—masterful men of pragmatic rather than philosophic character tend to be diverted to predatory projects. A homicidal struggle may then seem to them the only thing worthy of their steel. The moral equivalent of war is not readily at hand but there can be little doubt that free enterprise, stripped of predation, is the nearest thing to an answer consistent with social freedom.

#### UNEMPLOYMENT AS AN INHIBITER OF POWER AND FREEDOM

Aside from war, the principal disturber of mass security is a condition of general unemployment. The menace of such unemployment is the greatest inhibitor of non-predatory, and the strongest stimulus to predatory, enterprise. General unemployment is evidence of the bankruptcy of the economic system in which it occurs, since no economic or any other social purpose can be served

by involuntary unemployment but, on the contrary, will be frustrated by it.<sup>7</sup> Prospective enterprisers must not only have a reasonable prospect of success, which a condition of general unemployment denies them, but the *right* of every willing and competent worker to a job, at real wages in the close neighborhood of his specific real productivity, is not only implied in the right to life, liberty, and the pursuit of happiness (since none of these can, in any substantial measure, be achieved without it) but, on economic grounds alone, is an integral feature of any sanely conceived social "order." The right of entry into any occupation, and the right to a job, is the equivalent of free access to resources.

Almost as bad as no job at all is a job to which one is irrevocably bound. The mass of men may, by a set of masters, be given the same sort of security that they themselves accord to compliant domestic work animals. This is precarious, at best, since all safeguards against tyranny, lawless violence, rapacity and other sorts of persecution are then forgone. Men have always preferred a not badly ordered tyranny, which confirms some freedoms in compensation for those it takes away, to a state of chaos in which all power, and therefore freedom, is frustrated. But while they must have order they are never content with order and nothing else. There is, moreover, no inherent obstacle to the universal consummation of the right to work in freedom and, in a properly ordered society, it would be axiomatic. To ensure it is a primary social goal.

#### AFFLUENCE

As a consequence of greater power, as a phase of greater security, and as a facet of freedom, we may expect a rise in general affluence. This might conceivably be enervating, but, except on the part of those who adhere to a philosophy of renunciation and therefore look with favor on the most austere asceticism, there can be little question of the desirability of so much of it as, in the foreseeable future, is likely to be attained in even the most productive countries. When large sections of even the most prosperous populations are underfed, with most of the remainder subjected to fear of lack of the material necessities of a decent life for them-

<sup>7</sup> With full employment it would at least be *possible* to satisfy more fully the desires of all members of society, whatever those desires might be, than would be the case if any of the members were involuntarily unemployed.

selves and their families, the urgent character of the problem of increasing the output of economic goods and of attaining a modest general competence needs little emphasis.<sup>8</sup> Those to whom asceticism is attractive can take the course of poverty if they will, and those who, without any predilection for asceticism as a virtue, are indifferent toward their material environment may go their way without any consideration for affluence as a social goal, but to most men a higher general level of affluence will seem to be a necessary expression of social power and freedom.

#### OTHER BY-PRODUCTS OF POWER AND FREEDOM

Many other social goals are included in the catholic embrace of power-cum-freedom. The reign of wisdom, virtue, pleasure, happiness, and any other ends that have appealed to philosophers, will come, if at all, as a by-product of the exertion of appropriately distributed power.

All these things can be realized only in individuals; they have no objective existence; they cannot be imposed or even cajoled; they can flourish only in a kindly soil. The richer the matrix the more resplendent will be the jewels which will dot it, but a rich social life, or indeed any at all, is not conceivable apart from the life of individuals. Individualism and socialism, properly construed, are not antithetical but complementary and even identical things. No true comradeship is possible except on the basis of the fullest feasible recognition of individual personality. On the other hand, equality of opportunity, for the fullest feasible exertion of individual powers, is possible only through large concessions to the social entity.

<sup>8</sup> The progress in this respect is much slower than is often supposed. Thus the real income, per family, in the United States in 1940 (a very good year) was less than it had been three to four decades earlier. Families had declined, in average size, by about 15 per cent. (cf. *Essential Facts for Fiscal Policy*, National Industrial Conference Board, New York, 1941, p. 19.)

## CHAPTER III

### THE SETTING FOR SOCIAL GOALS

#### THE ONE AND THE MANY

THE dictum that man is a social animal is by no means so axiomatic as Aristotle seems to have supposed.<sup>1</sup> Man is not a social being, like bees or ants, in the sense that he cannot live except by complex social processes. He is not driven to persistent and widespread association by any compelling instinct but rather by the necessities of certain environments. He is social only in that he enjoys, or finds advantageous, certain types of intermittent intercourse with his fellows. It is, indeed, only because man is *not* in any comprehensive sense a social animal that social problems plague him. Men are willy-nilly forced into social relations from some of which most of them would prefer at all times to be free and, from others, to be free except on occasions over which they have full control. The facts are that, alternatively, from time to time and circumstance to circumstance, men are volitionally social and anti-social and that they become less continuously social, in any quasi-instinctive way, as time goes on. The wide range of taboos that surrounded primitive men and, in part at least, effected social cohesion, might not have been galling to unenterprising individuals with no lively consciousness of nascent and inhibited powers. But the taboos became intolerable with the growth of that individuality which is the distinctive characteristic of the ascent of man. The need for liberty increases in intensity as the intelligence and moral faculties develop.<sup>2</sup> Social arrangements then center around the problem of the one and the many, with the

<sup>1</sup> The translation usually given to πολιτικὸν ζῷον is "political animal" but it would seem that "social animal" is closer to the real meaning of the phrase. The reason that man, by nature, is to be regarded as more of a social animal than the bee or any other gregarious creature is, according to Aristotle, that man alone of all the animals possesses speech. (*The Politics*, Loeb Classical Library Edition, William Heinemann, Ltd., London, 1932, p. 11). Aristotle does not tell us how he knows that non-human creatures cannot, orally or otherwise, communicate with one another, and it would in any case seem that if, without communication, they act automatically in social fashion, they are, for this very reason, to be considered more social by nature than is man. The human need for solitude is, at times, overwhelming.

<sup>2</sup> cf. John Stuart Mill, *Principles of Political Economy*, W. J. Ashley, Ed. (Longmans, Green and Co., Ltd., London, 1926), pp. 204ff.

effort to give an ever larger play to individuality in an environment in which contacts of men with one another inevitably grow closer and more frequent.

#### TYPES OF SOCIAL ORGANIZATION

There are three general types of organization of the necessary work of humankind. These are: (1) Individual, or family, self-sufficiency, in which each unit produces what it consumes and consumes what it produces; (2) Division of labor, cooperative production, and enjoined distribution, on the basis of a status imposed and maintained by the force and fiat of any individual or group that can by whatever means establish its authority; (3) Division of labor, cooperative production, and the exchange of goods and services, on the basis of free enterprise, free contract, and free choice, within a framework of authority limited to the attainment of these ends and established by those who are prepared to cooperate toward their realization. It is rarely that any of these types of organization is found in pure form but such are the norms around which actual arrangements, with some deviations, cluster.<sup>3</sup>

#### THE SIMPLIFICATION OF SOCIAL PROBLEMS

An aggregate of self-sufficing individuals, or families, is logically the simplest type of social organization. As an exemplar of it we may take the pioneers on some of the successive frontiers in the United States in the nineteenth century. It is difficult to look back on this economy without a certain wistfulness. Freedom was there uncomplicated by the necessity for compromise, and the struggle to attain human goals was much less troubled by collision than it is in more complex communities.<sup>4</sup> Security against most of the ills of nature was, in some areas at least, not lacking, and the peculiar insecurity which has attended voluntarily cooperative production did not exist. There was no way to power except through produc-

<sup>3</sup> A fourth type is conceivable, that of anarchy within a group of individuals all of whom were so socially-minded as to bring about the conditions of type (3) but without the exercise of any authority. This is, of course, too beautiful a dream for this sinful world.

<sup>4</sup> Possible conflict, within the family, may be dismissed as irrelevant, with a note that the husband and wife were in a status arising out of (presumably) free contract and the children, being irresponsible, did not come within the scope of contract.



tion.<sup>5</sup> Distribution of income and the relation of reward to effort—matters which present the most difficult questions of justice in an exchange economy—offered to our pioneering ancestors no nut to be cracked. Desires and the effort to satisfy them were directly and automatically coordinated. No one could gain anything by obstruction or other restriction of supply. There was no possibility of conflict of the interests of producers and consumers. Savings and investment were made in physical commodities, were identical, and were therefore incapable of presenting the discrepancy which some observers think is at the bottom of most of the ills of later economies. Power over nature was on the increase and if material income compared unfavorably with that of some alternative systems the difference was not as great as is ordinarily assumed.

Much of the apparent advantage of large-scale production, with a high degree of division of labor, is nullified by costs which are not present at all in a system of self-sufficing units. A great part of the outlay for transport in our present economic organization, for instance, is occasioned by the fact that goods are ordinarily consumed at great distances from the places where they are produced. Transport is a heavy cost and it is illusory to count more than a fraction of transport services, whether of goods or passengers, as part of the social net income. Similarly, all the energy devoted to cajoling potential consumers into taking the things which producers have actually made, or are equipped to make, and which the consumers do not spontaneously buy, is practically wasted. Great effort must be put into the task of distribution of goods, into the wholesaling, and retailing, which are necessary when the supply of the various goods is not directly correlated with demand.<sup>6</sup> The task of regulation and accounting, which engages a large part

<sup>5</sup> It is assumed that external violence was precluded by the peculiarities of the environment and that assaults by one individual on another within the group were prevented by the simplest type of social organization—a local non-professional police in which all mature citizens might be called upon to serve.

<sup>6</sup> The Twentieth Century Fund in *Does Distribution Cost Too Much?* (Twentieth Century Fund, Publishing Division, New York, 1939), p. 119, estimates the average cost of getting finished goods into the hands of the consumer at 59 per cent of the retail price, which means, of course, that the cost of production, at the factory, is only 41 per cent of what the consumer pays. The distinction, in the book, between primary production and distribution is somewhat lacking in precision but the estimate of the cost of distribution, as compared with the negligible cost under a system of self-sufficing production-consumption, is almost certainly not exaggerated.

or all of the attention of police, judges, commissions of various kinds, bankers, lawyers, accountants, and clerks, is a further heavy burden. All of these costs of the system of social division of labor must be subtracted from the gain in per capita productivity *at the point of output of the goods*. When they are taken into account and when, in addition, note is made of the fact that the regulatory machinery more or less chronically works in halting fashion, and from time to time breaks down, the inferiority of the system of family self-sufficiency is by no means as great as is ordinarily supposed.

This is not to deny, but merely to qualify, the truth of Adam Smith's assertion that the division of labor is the chief source of economic progress. The productive gain from specialization is far from being without compensation but it is potentially large—so great, indeed, that a more or less unpremeditated metamorphosis into a society of the voluntarily cooperative character occurs whenever hitherto self-sufficing producers come into amiable contact with one another. Social problems then present themselves in growing complexity. The task is to preserve, as fully as possible, the fundamental principles on which the simplest of all free societies rests.

#### FIRST COMPLEXITIES IN SOCIAL ORGANIZATION

The early stages of the new development keep each producer an enterpriser, specializing in wheat or wool or wine as his talents and resources may direct. Presently, however, the process is carried farther. The members of the group, being human, will differ not only in capacity but in disposition. These differences will result in great variety in the amount, form, and disposition of the incomes sought and attained.<sup>7</sup> The more productive and provident members will be able and inclined to store part of their income. Such stores give to their owners the opportunity of proposing a release from risk to such of their fellows as are at once less provident and more interested in security (the safeguarding of a modest power) than in a chance for a larger affluence (the extension of power). Instead of all bearing equally whatever risks attend any given type of production (including the risks involved in fluctuations in the relative values of products), it is then possible to

<sup>7</sup> This would, of course, be true whether or not specialization was in vogue.

effect a concentration of risk upon those who have the means and the inclination to assume it.

The prospective risk-takers bargain freely with their fellows, offering to them, for their services in production, a fixed return in desired commodities regardless of the outcome of the enterprise. The amount of this return would typically be in the neighborhood of the income that, with average luck and given skill, each man could anticipate in enterprise on his own account.<sup>8</sup> The gross returns from the enterprise would, under the contract, accrue to the risk-taker, who would take a net gain or loss according as these gross returns surpassed, or failed to attain, that amount which he had paid out under his contracts plus so much as was sufficient to compensate him, at the same rate as the others, for the labor he himself put in.

This procedure has not only the advantage of providing a more generally satisfactory method of conducting simple production but is an automatic way to secure leadership, with preservation of the freedom of all concerned, in such enterprises as cannot be carried on at all without concentration of direction in a single head. Since the enterpriser assumes all responsibility for the success or failure of the project he will surely stipulate in the contract that he shall have direction of the work and, since the workers' returns will be unaffected by the result of the enterprise, no worker will have any reason for great concern as to whether the work is done according to the enterpriser's ideas or his own. If, after some experience, any worker finds the regime of any given enterpriser intolerably irritating, it is open to him to contract with another, to set up as an employer himself, or to revert to self-sufficiency.

To the extent that those men who have accumulated the necessary resources, and have the inclination to accept responsibility for the risks of enterprise, are able to supply better direction than has previously been, or can otherwise be, obtained, their gains will normally exceed losses so long as they offer to workers only as much as could, on the average, be obtained under some other scheme of organization. The competition of enterprisers for the services of workers will then be enhanced and they will be compelled to pay so much more as, with all the members of the

<sup>8</sup> It might be slightly more if the members of the group, as a whole, were inclined to take chances, and slightly less if they were disposed to play safe.

community engaged either as enterprisers or workers, will make it a matter of indifference to some of the group whether they assume the one role or the other. If wages should fall below this level, some men will abandon the role of worker for that of enterpriser. By reducing the supply of workers, and increasing that of employers competing for the workers' services, wages will be forced up to the equilibrium figure. If, on the other hand, wages should go above this level, some enterprisers will, on balance, obtain losses rather than profits and will, or must, revert to self-sufficiency or accept employment as workers under the direction of more capable enterprisers.

None of the participants in such a privately directed enterprise has lost any freedom. It is true that the workers must, in the course of their work, take orders from the enterpriser, but they freely contract to do so under a revocable agreement which gives them that security against loss which they value more highly than the opportunity for profit. The power of all is increased and takes, in each case, the form appropriate to individual disposition. Equality of opportunity is substantially maintained and the attainment of all social goals is furthered. This is the "simple and obvious system of natural liberty" on which the classical economists relied in their quest for a practicable Utopia. It involves an easy shift from the category of worker to that of enterpriser and vice versa.

#### THE WORM IN THE APPLE

The development of an exchange economy, nevertheless, opens the way to human exploitation through the potential increase of the power of some members of the group at the expense of others and of the group as a whole. This exploitation is effected through an alteration in exchange relationships, which move in favor of those who can curtail the relative supply of the goods or services they have to offer. A diversion of income, moreover, to those who obstruct, but for a payment will permit, the process of production and exchange is always possible. In both cases the power of the group is not only distorted but fails to find full expression. Such a development could be prevented if access to resources and to occupations were free, if the cost of a shift of occupations were negligible, if a sufficient number of men were versatile enough to move into any occupation which offered a relatively favorable op-

portunity, and if production, somewhere, were always more advantageous than abstention from it.

It is because these conditions were not present in the society they left that the pioneers in this country broke new ground. They were seeking to escape from an environment where the development and distribution of power was not in the social interest and where the inequities bore with peculiar weight upon them. But, so soon as the growth in their numbers, and of their powers and aspirations, brought on a relative scarcity of resources in the new situation, while the pristine technology could no longer satisfy their developing desires, they were faced with social problems similar to those from which they had already fled. These they could no longer escape but must tolerate or solve. They did not solve them.

Freedom, of the type the pioneers enjoyed, was the product of a unique environment and was so far from being natural, in the sense of normality, that we have no record in early history of anything like it, we do not find it in operation among primitive peoples of the present day, and once established, in outline at least, it did not, in any purity, survive. It called not only for the suppression of internecine fighting, and a fortuitous isolation from powerful external attack, but for natural resources so bounteous, relative to population, as to prevent exclusive appropriation of them, for forms of production so simple that men could readily shift not only from one product but from one function to another, and for a minimum of social contacts. It is probable, too, that the pioneers were a selected group in whom the impulse to enterprise was strong and that the system they set up could never be other than an excrescence from society at large.

#### THE LOGICALLY SIMPLE AND THE CHRONOLOGICALLY RARE

It is therefore not surprising that the system has few or no recorded prototypes. The suppression of internecine fighting, without a concurrent and widespread suppression of freedom, has not often been attained. This tale, indeed, is as yet by no means fully told. Compulsory cooperation was no doubt the basis on which the earliest human associations were built and, throughout history, it has continued to play a leading role. The first forms of *voluntary* cooperation, on any scale that could be called social, probably

occurred in alliances of the oppressed against their oppressors. Some approach to social principles as a basis for such alliances must have occurred but, if the alliance was successful in establishing its power, the principles on which it was formed were seldom applied in dealings with the vanquished. Arbitrary power, however obtained and exerted, was in general the cohesive agent. Physical might was no doubt important but it was early supplemented, and even largely supplanted, by innumerable forms of superstition. Almost all societies have therefore been of the second general type, that in which status is the dominant note and a general freedom conspicuous by its absence.

The notion of general freedom was, in fact, so alien to immemorial custom that it was not until the time of the fathers of men now living that the idea of status was widely impugned. Contract as the basis of the organization of society, and of all the relations among its mature members, received in the thoughts of men nothing but the shortest shrift until the eighteenth century was well advanced. The Greeks had, of course, played with the idea, but slavery was an accepted institution to which even Plato gave his sanction; the Roman law, especially the *jus gentium*, had given to freedom a limited measure of recognition; and the Levellers and other rebels, such as the less violent Puritans, had forced it on the attention of the English.<sup>9</sup> But it was only after the French revolution that the idea of the liberty, equality, and fraternity of all mature citizens was in any state accepted, even in principle, to say nothing of being put into practice.

In the past few decades, moreover, we have been steadily moving away from these revolutionary ideas until so acute a commentator as Roscoe Pound can *deplore* the reluctance of our courts to admit the validity of legislation which assumes the existence of "classes," that is, status, in our society.<sup>10</sup>

<sup>9</sup> The Puritans in this country, however, once they had attained power, did not long adhere to the principles of the Mayflower Compact which was an attempt to organize a society, *ab ovo*, on truly social principles. An ecclesiastical oligarchy was not slow to assert its authority. It was "the rich, the wise, and the good" who felt that they were the vicegerents of God, especially in His aspect of Power. There was little doubt that the rich were rich but that they were wise and good was purely a self-estimate on the assumption that the riches were evidence of wisdom and of virtue.

<sup>10</sup> cf. *The Spirit of the Common Law* (Marshall Jones Company, Boston, 1921),

## FREEDOM AND FORCE

The substitution of the principle of contract for that of status, which Sir Henry Maine rightly conceived to be the essence of civilization, has, of course, its limitations. Except in a society of which all the members had attained the moral maturity of angels coercion must have a place. Prisons, or their equivalent, are necessary in restraint of those who insist upon seeking their ends in other than socially tolerable ways, and fighting may be necessary before they can be incarcerated.

No community can be permanently organized without a modicum of force. Not only can there be no use of contract with those who indulge in positive anti-social actions but there can be only a partial use of it in the ordering of those human relations in which the consequences of actions cannot be segregated to individuals in correspondence with their share in them.<sup>11</sup> But, though contract cannot be universal, the pursuit of social goals requires its persistent extension.

The only principle which will not lead to an unfathomable bog of controversy over "rights," to civil war, or to real tyranny by individuals or minority groups over their fellows, is unequivocally to set the *res publica* above any individual's will in cases where contract is not applicable. To effect a release of the powers, and therefore to expand the freedom, of the citizens as a whole, the group must be permitted not only to restrain those who insist on a positive use of illegitimate force but also to constrain those who prevent others from exerting their just powers. The *res publica* must be supreme and the power to enforce it unassailable. Against it the individual, though he be granted privileges, has no indefeasible *rights*. But for this reason, if no other, the presumption is always against any extension of the lateral scope of the power of the state. The *depth* of the power must be limitless and the draft

p. 135. It should be said that Dean Pound's sympathy lies with the less privileged "classes," but the point is that he takes the existence of privilege with equanimity if not complacence.

<sup>11</sup> The taking of sanitary precautions against an epidemic might, for instance, be rendered completely ineffective by the recalcitrance of a few individuals who did not believe in them, and the noxious consequences of their conduct might be visited largely, or even solely, upon those who had done their individual best to avert the evil.

upon it less or greater in correspondence with the shift of circumstances from placid progress to highly disruptive emergency. But the *width* of the power should always be jealously restrained.

#### THE SPIRIT OF CONTRACT IN GOVERNMENT

Even in the field of government, the *spirit* of contract can be preserved between all those who, as fully represented members of the whole, consent to accept the social will as their own. The methods of determination, and application, of the social will, in the reconciliation of power and freedom, must be established in a hypothetical social contract, perpetually renewed as adolescents reach the full stature of citizenship, but fixed in its fundamentals. The alternative is reversion to the law of the jungle and the abandonment of goals which can, in any meaningful sense, be called social.

As an explanation of the origin of government the doctrine of the social contract has been the target of the slings and arrows of outraged scholars for many decades. But to interpret the social contract theory in this way is to miss the import of one of man's most fruitful ideas. "Unhistorical in the foundations on which it was built, it was . . . directed, in its efforts and its results, not to the purpose of scientific explanation of the past, but to that of the exposition and justification of a new future which was to be called into existence."<sup>12</sup> So considered, the social contract theory becomes a revolutionary doctrine the ramifications of which imply readjustments in every area of social life. As advanced in the eighteenth century, it challenged, and was recognized as challenging, the established privileges of uncounted centuries. In its ultimate implications the contract theory was probably more foreign to traditional thought than the theory of communism, using that term in its classic sense. The idea of social authorities holding all property in common, allegedly for the general welfare, was a venerable and respected thesis; the idea of men, independent of ecclesiastical or social rank, meeting in essential equality before the law, and in the market place, was new and iconoclastic. The work of the doctrine is by no means yet completed.

<sup>12</sup> Otto Gierke, *Natural Law and the Theory of Society*, translated by E. Barker, (Cambridge University Press, Cambridge, 1934), vol. 1, pp. 35-36.



## LIMITATIONS ON SOCIAL CONTRACT

In the social contract each of the tacitly contracting members agrees to accept loyally as his own deeper will, and to abide by, the decision of the group as a whole. The ideal is to have unanimity of opinion as to what should be done in any specific case. This ideal can seldom, if ever, be fully attained. To attain the closest practicable approximation to it there must be free speech, discussion, education, and compromise. On matters on which an early decision is not essential, on pain of general extinction or other imminent disaster, the process of reaching such a decision as will satisfy the evolving wishes of all, or a very heavy majority, of the members of the group, may be leisurely. On those matters on which *some* decision must be reached quickly (even though it prove far from ideal and indeed inferior to that desired by those who are, in the event, overridden) it may be requisite to act on the will of a bare majority. This, however, is merely an additional reason for limiting the lateral scope of the sovereignty of the majority. The adhesion to the will of such majorities is not to be taken as other than the best practical expedient if the larger ends of the group are to be preserved at all.

It is evident that the greater the consensus the stronger is the case for action—and the whole republican process is an attempt not to insure the triumph of a mere majority but to secure as comprehensive a consensus on any necessary social action as the nature of the case will permit. A 100 per cent consensus is an impossibility on almost any proposal. But by free and patient discussion, by compromise of conflicts, by conciliation which does not involve a vital principle, by a process of education, by equal presentation of all points of view, through the play of reason, something not far short of this may often be attained.<sup>13</sup> The more the consensus falls short of 100 per cent the greater is the element of arbitrariness in a quite disproportionate degree. The ideal here is not that of a game, in which a win by the narrowest of margins is as valid as a walkover, but the satisfaction of as many wills as fully as may be and the consequent overriding and frustration of the smallest prac-

<sup>13</sup> cf. A. D. Lindsay, *The Essentials of Democracy* (University of Pennsylvania Press, Philadelphia, 1929), pp. 31ff. Reason, in this sense, is practically synonymous with justice as earlier defined.

licable number. In some cases there may not be time, again on pain of disaster, even for a referendum, and these cases must be provided for in advance through the election of delegates who will be given the authority and duty to act for the group. Such procedure is, moreover, obviously convenient in all matters of administration in which no important principle is involved.

In times of great emergency it may be necessary greatly to expand the authority of delegates, or even to set up a (revocable) dictator, since the slow processes of "pure" democracy will then be intolerable. This method for dealing with great emergencies, while still preserving what freedom had been attained, has precedents of long standing as, for instance, in the Roman republic where the consuls were made dictators for limited periods. There are some advantages in fixing a short term with recall of the powers at the end of it and some in leaving the term indefinite with the ever present possibility of immediate recall. The former may, on the whole, promote the unity in that cooperation necessary toward the simple and supreme end of mastering the emergency; the differential virtue of the latter is that it is likely to be more effective in preventing the consolidation of the dictator's power and the subversion of it to the purpose of rendering that power, in fact if not in law, irrevocable. Vigilance by the sovereign people is essential in either case but, so long as the group as a whole retains the possibility of transferring, from one head to another, the powers necessarily concentrated for dealing with an emergency, the essentials of freedom are not in danger.<sup>14</sup>

Temporary dictatorships, with delegated powers, are in fact converted to permanent irrevocable tyranny only in societies which may once have known relative freedom but in which freedom has long been corrupted. The practice of granting temporary dictatorships in times of emergency, in Rome, preserved rather than subverted freedom for the better part of a millennium. Dictatorships were not perverted into imperial rule until long after freedom had been subjected to steady corrosion. Such corrosion, it may be added, is the present state even of those countries which are the champions of what freedom there is in the present world.

<sup>14</sup> I know of no better discussion of these, and other governmental, principles than that in the *Federalist papers* of Madison, Hamilton, and Jay.

Their eminence in freedom, such as it is, arises in considerable degree from the flatness of the circumscribing area.

Most of the cooperative business of the world, private or public, is necessarily done under the *forms* of dictatorship, though this may be a relationship arising out of a contract revocable at the will of either party. No enterpriser could permit his workers the freedom to refrain, as they might choose, from carrying out his orders, though they may, at any time, quit the job. The captain of a ship, in all matters pertaining to its navigation, must be obeyed instantly and without question by every member of his crew or all will, with practical certainty, perish. The freedom to quit is more limited in this case but it is still present. The immediate governing group in any society is always an oligarchy and no citizen may freely flout the relevant commands of any administrative officer from President to policeman. The town meeting method of running affairs can be applied only to questions in which quick decision is unimportant and even there the views of such a majority as can be obtained, when the decision is eventually made, must prevail over those who, on the particular question in hand, are in opposition.

#### THE STATE AS AN ABSOLUTE MONOPOLY

Freedom is not impaired, under the system of command and obedience, provided withdrawal from the organization in question is open to all at any time. The essential difference, for freedom, between the state and practically all other cooperative organizations in modern times, is that association of the individual with it is not left to his own choice.<sup>15</sup> From other organizations a man can, by withdrawal, preserve his freedom whenever he feels that it is impugned. If he makes a contract involving association with others he may not, of course, freely withdraw from the tie during the term of the contract; but he does not have to enter into the contract. With respect to the state, however, he has no such freedom. It was possible, in days before the world slipped back toward barbarism, freely to choose the state to which one would adhere but, once the sovereignty of states had been established all over the habit-

<sup>15</sup> In former times this was also true of such religious organizations as were, in fact, state churches, and it is still true, to a somewhat lesser extent than formerly, of the family. Freedom and equity are conditional upon individual responsibility; they cannot be absolute. No man liveth unto himself alone.

able world, there was no means open to any individual of deliberately avoiding some political association and allegiance.<sup>16</sup>

This fact greatly strengthens the case for limiting the lateral extension of state action. Since the individual cannot, without the state's consent, sever that association with a given state which derives from the circumstances of his birth (which he cannot control) and cannot, in any case, divorce himself from association with *some* state (which, to assure a general freedom, must have the power to coerce him), it is a condition of any substantial freedom that states should exert their control only when objectives, quite legitimate in themselves, cannot be attained in any other way.

If it is the social will (adequately ascertained) that certain projects be undertaken which cannot be brought to fruition without universal cooperation, or will not be initiated privately because private cooperators cannot appropriate to themselves the benefits of their cooperation, the thing must be done by the state.<sup>17</sup> But, in a broad sense, the coercion of coercions, positive or negative, covers the state's appropriate functions. All the rest may, without any loss and with much gain, be left to private individuals, or private associations of such, to perform for themselves. Not only economic but the great bulk of moral and cultural activities, in all their immense variety, are within the purview of private action, and it is on this that we must mainly rely for the more specific forms of social progress and even for the definition of its specific content.

#### TERMS OF THE SOCIAL CONTRACT

The terms of the (hypothetical) social contract, covering necessary state action, may therefore be presumed to be as follows.

The contracting individuals agree that:

1. There shall be no coercion of any member by any individual or by any group other than that formed by the contract. In this group every mature person, willing to subscribe to the principles

<sup>16</sup> The mere growth in numbers, and consequent crowding, would have brought this about in the absence of any other favoring factors. Thoreau's protest against the state as such was essentially childish, a hankering for the unattainable.

<sup>17</sup> The light of a lighthouse, for instance, shines equally upon the just and the unjust, upon those who pay its cost and upon those who do not. Since their benefits cannot be exclusively appropriated, lighthouses will not be privately built except by altruists. Altruism, perhaps unfortunately, is inadequate to the need.

of the contract, shall be entitled to equal representation as the counterpart of the assumption of equal responsibility.

2. Each will refrain, except as an agent of the group, from coercing any mature individual whether within or outside the group. Every mature individual will therefore have a title, inviolable against invasion by any other individual or by any sectional group, to the product of his own hand or brain under a regime of work, voluntary abstinence from immediate consumption, fair persuasion, free contract, and free competition.

3. Coercions, attempted by private persons, private internal groups, or external enemies, shall be resisted by the group as a whole and, to make this resistance effective, each recognizes a duty to assist.

4. Each accepts as his own the will of the whole in matters in which state action is the only means of getting any action at all.

5. The state shall attempt no action not designed to frustrate positive or negative coercion of individuals by other individuals, sectional groups, or external enemies.<sup>18</sup>

6. No one shall be denied access to the resources necessary to the maintenance of life or the exertion of constructive power and, so far as possible, all members on attaining maturity shall be given equal access to those resources.

7. Every feasible effort shall be made to secure on any proposal for social action as large a consensus as the urgency for *some* decision permits, the ideal being unanimity.

8. No state action shall be taken except such as will increase the power of the group as a whole.

The essence of such a contract is the distribution of private power in such a way as to assure an equal opportunity to all who, as individuals or minority groups, will abstain from coercive conduct. The absence of private coercive conduct is nearly synonymous with free competition. The conditions of free competition will be later developed. It may here be noted, however, that no approach to them will, in a complex society, ever be attained without drastic, though not ubiquitous, governmental action. Coercions of others, by private individuals, cover much more than

<sup>18</sup> A negative coercion may be defined as an obstruction of the social will; but a peaceable attempt to change the will is not to be construed as an obstruction.

simple violence and it would be illusory to think of the state as other than an alert and active participant in the establishment of the conditions of freedom.

#### SOCIAL OUTLAWS

If any resident of an area so organized refuses to subscribe to such a compact or, after expressly or tacitly adhering to it, repudiates it in a refusal to abide by the will of the whole, he becomes an outlaw, a social pariah, with no claims that the society, as such, is bound to respect. Any leniency of treatment that he may receive will be a matter solely of grace. No grace can be expected to cover cases menacing the safety or freedom of the contracting members or other jeopardy of the fundamentals of the society. The subscribers to the social contract can safely give no freedom to those who purpose to destroy it.<sup>19</sup> A "liberalism" which refrains from disarming those who are its deadly enemies has lost all contact with reality and is bent on suicide. The one thing that, in a truly liberal society, may not be tolerated is intolerance of the principles on which it rests. Those who demand tolerance of such intolerance can expect no shrift from those who are resolutely committed to the defense of freedom. The certain alternative to general hostility toward men who refuse to subscribe to the social contract is the restoration of conditions under which those shall take who have the power and those shall keep who can.<sup>20</sup>

<sup>19</sup> We should not forget, however, that the graciousness of the treatment of unpopular minorities has rightly been declared to be a good test of a civilization. Though the citizen has no inalienable rights when the exercise of such alleged rights would endanger, or ruin, the safety and freedom of most, or all, of the members of the community, the government, on the other hand, cannot rightfully invade the long-run objectives of the social contract, or take any action which reduces the ordinary immunities of the citizen, except when this is absolutely necessary to ensure safety and freedom in the end. It is, moreover, imperative that a society, as well as an individual, live somewhat dangerously if freedom is to flourish. Underminers of the social contract may well be given rein when there is no clear and present danger from their action and such a policy will diminish such danger as there may be.

<sup>20</sup> The fact that there is no tolerable alternative to subscription to a "rightly" conceived social contract, and that men are born into a social order which they did not make or choose, may seem to place a limitation on the concept. This has often been pointed out in the long controversy over the doctrine. The very idea of contract involves the presence of a feasible alternative, and a frame of reference within which "legitimate" contracts may or may not be made. The eighteenth century political theorists thought they had found this frame of reference in the ra-

## LAWLESS MAJORITIES

Freedom may be threatened not only by powerful minorities but by irresponsible majorities seeking not an expansion of the general power but an arbitrary redistribution of the fruits of such power as may have been quite legitimately exercised. Conceptually such a majority is composed of individuals who are outside the scope of the social contract, to which, as their actions show, they have refused to subscribe. The majority of participants in the social contract is not identical with the majority of (physically) mature members of the state. The "right" of a minority of the members of a state to resort to violent opposition must, therefore, be conceded, nay asserted, when that minority is upholding the principles of the social contract against a larger group bent on breaking them. Rights, only attainable through assumption of obligations, always derive from a social, never from an anti-social, milieu.

A dissolute majority may grossly exploit a minority of the population and finally involve all in ruin. This is especially likely to happen where political associations which may have been originally formed to promote quite legitimate specific objectives are perverted into seeking control of the state for the purpose of plunder ("to the victor belong the spoils"). Political parties are peculiarly prone toward this disease and typically pass through a cycle which begins with an organization based on issues and passes to a status in which the only issue is the organization itself. Loyalty to principle is transformed into loyalty to party and the party seeks

tionale of *natural rights*. But the content of *natural rights* is itself a social product varying from society to society and from epoch to epoch. There is in fact no escape from the dilemma of coercion to secure freedom.

Those who would refrain from, or break, the social contract may be seers rather than sinners, but the society has no alternative to treating them as criminal. The seers may set up a revolutionary situation, involving a shift of power, but it is difficult to see how the problem of power could ultimately be solved other than in the manner outlined in the preceding pages. It might, of course, be maintained that the law of the jungle is the best possible code for human action. The outcome of a wholly unregulated struggle for power might, to some deity or seer, seem best for man, but this, whether good or bad, is not a social process and is out of place in a discussion of social goals. The seers and near-seers should be given every opportunity, short of violence, to convert their fellows but they can have no *right* to violent revolution against a social order based on the restraint of violence and the maintenance of freedom. It is only in such an order that *any* right has its origin.

issues to increase its strength rather than the strength to promote the purposes for which it was brought into being. This is a common outcome when a legitimate issue for which a party was formed has disappeared in success. The *raison d'être* for the party is then lost but the organization has become powerful, with its power open to abuse by those who can hold the organization together. As so often happens in history the means to an end then becomes an end in itself which is in turn used as a means toward ends, usually vicious, which bear no relation to those originally sought.

All sorts of devices designed to check precipitate or other arbitrary action by majorities have their uses but the ultimate safeguard against abuse of state power in the interest of a politically powerful majority lies in insistence upon those provisions of the social contract which limit the sphere of operation of the state. It is difficult or impossible to define this sphere precisely. For this reason there is often an addendum to written political constitutions guaranteeing to the participants specific "inalienable rights" against the will of the majority. None of the allegedly inalienable rights can, however, be absolute and, in certain emergencies, they are subject to temporary invasion as a preventive against their permanent extinction. It should always be remembered that loyal adherents to the social contract are the only *social* individuals, or group, and that all others are recreant, servile, or criminal.<sup>21</sup>

#### CORRELATION BETWEEN SCOPE OF STATE ACTION AND THE PERVERSION OF POWER

If the sphere of the state is narrowly confined and, with such precision as possible, prescribed, the desire for control of the state on the part of sectional groups will fall short of passion. The

<sup>21</sup> The case of the conscientious objector to war, to any other enterprise involving coercion by a government responsible to the (hypothetical) signers of such a social contract as that outlined above, or to taxation, is here in point. Such an objector has no *rights* whatever, since he refuses to assume the obligations which are indispensable to the establishment of a social organization. When he refuses to assume, or repudiates, such obligations he elects to fend for himself in a human jungle and can assert no claim to protection and assistance from those whom he will not help to protect. There can, let it be repeated, be no rights without the assumption of responsibility and obligation. What *grace* the community will allow to a conscientious, or other, objector to social action is purely a matter of expediency.



struggle for control grows inordinately keen, however, with every extension of the lateral scope of action of the state. The struggle once begun requires the intervention of the state itself and the intervention of the state exacerbates the struggle. The success of any group in this struggle is largely a matter of historical accident. Whenever the state permits the concentration of power in the hands of a very few antagonistic private groups, however, the inevitable outcome of the resulting chaos is the decisive victory of one of the groups or the subjection of all of them to a new group formed solely for the purpose of exerting totalitarian power.

Many writers on political topics have believed that all power is of economic origin, but the fact is that any type of power over men tends to aggregate to itself other forms of such power. There is no more reason to believe that so-called economic power confers other forms of power on its possessors than that other forms of power confer so-called economic power upon those who can exert them. The rich are not powerful because they are rich any more than they are rich because they are powerful. With whatever type of power one can establish dominance over men all other types can be attained. The Normans who came to England with William the Conqueror were not rich when they arrived but were not long in acquiring that which made men rich in their day. The theocracy in New England, which paid obeisance to an extra-mundane ecclesiastical power in order to establish its own secular sway, quickly added economic power to its priestly and political sovereignty. The early Christian Church started poor but became immensely rich after it had captured the seats of the mighty in other fields. The Nazis began as economic outcasts in a lowly beer hall but they ended in totalitarian power within their state, supreme in politics, religion, law, the military and the economic life. Their leaders attained political power and all the rest fell into their laps. Their political power, in turn, was derived from the exploitation of superstition, a form of priestly power. When, on the other hand, they lose power in this or any other field, their power as a whole will be endangered or will collapse.

#### ECONOMIC POWER AND POWER IN THE ECONOMY

Economic power, in the narrow and precise sense, does not confer any power over men at all. Strictly construed, it means pro-

ductivity, whereas, in the broader and looser sense of the term, it means any sort of power which is clothed in economic habiliments. Not infrequently this is the power to obtain satisfactions by subreption or by excluding other men from the opportunity to exert their economic competence in their own behalf. Such predatory power is in fact political rather than economic.<sup>22</sup>

In the days before the institution of private property (in anything, at least, but purely personal articles) gave to the common man a chance to stand on his own feet, so-called economic power lay with those who by military, priestly, or other political means could skim off the cream of whatever was produced by the coercively organized collective effort. After the institution of private property, so-called economic power fell to those who, by hook or crook, could arrogate to themselves that form of property which, in the circumstances of the time, was strategic.

When land was the scarce factor in an economy, those who could get land by discovery, conquest, inheritance, violence, or subreption, had the means to power. When land became relatively less important, both because new lands had been discovered and because new products required little land compared with other factors of production, the power of landholders declined. Landlords were then replaced as the dominant class by such merchant-middlemen as stood at the waist of the hourglass of production-consumption, could organize a quasi-monopoly either as buyers or sellers, or both, and exploit those who supplied them or those whom they supplied. As economic life took on an increasingly pecuniary cast the merchant-middlemen lost ground to the financiers. When productive competence became a subordinate factor in the ability to navigate the business sea, and increasing amplitudes in business fluctuations made pecuniary liquidity all-important to success or failure, those who possessed the key to liquidity moved into the position of dominance. This brought to the fore the bankers who, under modern conditions, were able not only to get the use of other people's money but also, within greater or lesser restrictions, to manufacture money at will out of their own promises

<sup>22</sup> Economic power, strictly construed, is power to get things by work, whereas *realpolitik* is the art of taking them from others with a minimum of trouble to the taker. Business, in contrast with economics, relies heavily on *realpolitik*. A truly social politics, on the other hand, rests on the same principles as a social economics.

(turn their own debt into money). In this way they rose to power whenever enterprisers in other lines were caught in a web of illiquidity and were forced to surrender to financiers, or financial institutions, on whatever terms these latter might see fit to impose.<sup>23</sup> The largely successful attempt of large corporations to escape from the toils by building up strong liquid positions has, once again, effected a certain shift of power.<sup>24</sup>

The social interest requires that all these forms of uneconomic power (that is, unproductive power) be broken down by political action. Landlords were so restrained in republican Greece and Rome; landlords themselves put some restraint on merchants as the latter came to greater power; and financial power has always been vulnerable to sufficiently resolute attack. When, in Russia, the so-called economic power of bankers was no longer supported by the power of legal and political institutions, those who had seized political power broke the power of the possessors of liquid funds through the monopolized issue of so unlimited a flood of money as to make liquidity, to all but the issuers, a source of weakness rather than of strength. This was efficacious in breaking down the existing distribution of power but it brought on chaos which, as is not unusual, was resolved through the substitution of a new despotism for the old.

#### THE MATERIALISTIC INTERPRETATION

There would, however, seem to have been no inevitable necessity about any of these processes. There is, no doubt, a measure of truth in Marx's thesis that in "the social production which men carry on they enter into definite relations that are indispensable and independent of their will; these relations of production correspond to a definite stage of development of their material powers

<sup>23</sup> Restrictions on the private manufacture of money occasionally forced illiquidity on the bankers. But in recent decades such restrictions have always been relaxed whenever the pressure was great. This was always justifiable, immediately, as being in the social interest. Central banking institutions were set up mainly to bail out the private bankers at such times. Such institutions bought the bankers' assets with their own debt, thus permitting the bankers to pay off their debts and escape from a situation in which they would otherwise have been ruined. Society felt that it could not afford to let the bankers fail and this has fixed their power, especially since other forms of business were not treated with any such tenderness.

<sup>24</sup> In the modern (pecuniary) world, liquidity is (usually) power and tends to give control to whomsoever has the strongest cash position. If one seeks to "make" money, it is wise to go where money is or can (literally) be made.

of production. The sum total of these relations of production constitutes the economic structure of society—the real foundation, on which rise legal and political superstructures and to which correspond definite forms of social consciousness. The mode of production in material life determines the general character of the social, political and spiritual processes of life.”<sup>25</sup> But power may take an infinite variety of forms, as many in fact as there are ways of influencing individual and crowd behavior, and each form may modify the others. No one form of power is primary or can ever be sure of triumph. Power is self-aggrandizing but it also tends to evoke a coagulation of opposing power. The forms and location of power over men have constantly shifted in the course of history, not only as a result of a more or less spontaneous change of conditions but also as a result of the ceaseless struggle for alliances of (separately) weaker against stronger groups. An aristocracy of the military caste or the priesthood, or a power group of any other type, will find it to its advantage to make firm its control of the means of subsistence wherever it can. It may, however, be checked by accident or conscious social action designed to effect a balance of powers.

All institutional determinisms, such as that of Marx, meet their acid test not in the endeavor to account for the past—for the facts of history may be classified from an infinite number of perspectives without giving a determinate indication of the dynamic forces involved—but rather in terms of their hypotheses for the future. The Marxian thesis that because modern industrial production is communal production—that is, requires the social cooperation of innumerable individuals and units of enterprise no one of which could survive without the others—and because the mode of production (allegedly) determines the class structure, therefore the social structure, and industrial control, will be communal, is comparable with the idea that, because stock ownership must be diffused in order to secure the capital for modern enterprise, the control of modern enterprise will of necessity become more democratic as corporative enterprise grows. In fact, the result in both cases has been just the opposite. The very interdependence of the

<sup>25</sup> Karl Marx, *A Contribution to the Critique of Political Economy*, translated by N. I. Stone (The International Library Publishing Company, New York, 1904), p. 11.

several parts of the economic structure of Russia, in so far as that country has been industrialized, has enabled a small group in key positions to dominate the entire process in a way which would have been impossible in the era of less interdependent production. Similarly, with the modern corporation, the aggregation of power secured through uniting the savings of a considerable group has enabled a small financial and executive nucleus to obtain power out of all proportion to its social function.

The whole scheme of Marxian thought begs the question of power because it places final *causality* in the institution and not in the allied interests of the individuals who use the institution as an instrument of power policy. Without being dogmatic, it may be said that, while modes of production have given rise to social classes, it is equally true to say that social classes have given rise to modes of production and, what is more important, to techniques of control of the mode of production and the distribution of wealth which stems therefrom. A politically established classless (i.e. status-less) society could determine the conditions of production just as certain modes of production might produce a status-less society.

#### CONSCIOUS CONTROL OF INSTITUTIONS

The appropriate setting for such a society is inevitably a political republic under a system of free enterprise. Except in a republic the full measure of social freedom cannot be realized. (The interest of minorities must be protected, but not favored, by constitutional restraints and a balance of powers.)<sup>26</sup> Nor is the full measure of social freedom conceivable where individuals may not undertake enterprise, including the sale of their own labor, on their own responsibility and risk, with private property freely disposable through free contract in free markets.<sup>27</sup> This does not mean that

<sup>26</sup> The political struggle to place restraints on arbitrary power has a history of fairly steady development, in Anglo-Saxon countries, running back for at least seven hundred years. The movement is paralleled in other countries which have emerged from, and have not reverted to, barbarism. This evolution must be accounted progress and no reversal of it, however enthusiastically acclaimed, can be other than retrogression. If other than political freedom has suffered as political freedom has increased the solution is to attack the restraints on these other freedoms and, where they conflict with political freedom, secure an effective compromise.

<sup>27</sup> Without an all but sacred right to private property freedom is impossible since, otherwise, any individual is completely at the mercy of the governing authority.

society may not own, collectively, large amounts of productive property, especially where, under private ownership, free competition cannot be maintained or can be maintained only at heavy sacrifice of most of the primary social objectives. It does mean, however, that the holding of property and the choice of methods of exercising powers shall be free and wide to every man and that, whatever more or less lengthy bindings of conduct there may be, shall be made on a truly contractual basis and in the presence of feasible alternatives.

It is possible that, in a form of industrial selective draft, men might be thrust by arbitrary sovereign authority into the economic niches which, on the basis of a narrowly construed comparative productivity, they could most appropriately occupy. But this would involve the repudiation of all but one social objective for the sake of a merely temporary improvement in industrial "efficiency." Such would be desirable for the conduct of a war, in which the sole social objective is preservation of the mere *possibility* of freedom, but it is otherwise anathema. An important part of net income is the choice of the nature and conditions of one's work. Not only must it be open to men to choose the method by which they may make their living but, subject to limitations on inheritance for the preservation of equality of opportunity, to choose also how they shall dispose of the reward for whatever services they may render.

#### THE "CASH NEXUS" AND FREE COMPETITION

There would seem to be no method of assuring this other than through a free play of the supply of services in correspondence with a demand conditioned solely by free choices and the offer of the required *quid pro quo*. Much contempt has been heaped upon competition and the "cash nexus." But competition and the "cash nexus" is the only means of securing social cohesion which offers any prospect of general freedom.<sup>28</sup> Most of the abuses attributed

<sup>28</sup> It was, for instance, the commutation of feudal services into money payments, and the evolution of a pecuniary economy in the free cities, which broke the bonds of medieval serfdom. On these bonds, Carlyle, in *Past and Present*, could look with some nostalgia (largely because he was never subjected to them) and, in such contemplation, could pour out his vitriol on a (perverted) competition and the alleged evils of the "cash nexus." Where social relations are not based on the "cash nexus" as, for instance, in such a non-pecuniary civilization as that of the Aztecs, freedom

to the "cash nexus" arise from the fact that we have never had a well-conceived monetary system, while most of the abuses attributed to competition are in truth those of monopoly. The suppression of free competition is, in fact, the inception of slavery.

The realization of social goals requires that competition be free in the sense that it take place within a framework which will ensure its maintenance on a level at which the use of power otherwise than in work, foresight, thrift, free contract, or fair persuasion is banned. The level at which competition is carried on is much more important to freedom than is the mere fact that no one is excluded from the contest. The appropriate level, far from being natural, can be maintained only by resolute social action.

There is a steady tendency for competition to take the lower, more natural, forms, characterized by guile, oppression, and fighting without rules or restraint. It is a primary function of government, as the organizer of freedom, to raise the level of competition and to forestall the steady impulse toward degeneration once the level has been raised. The power and freedom which are the pre-eminent social goals can, in short, be realized only in the type of competition that will develop most fully the capacity, and opportunity of expression, of that part of the personality of every individual which is socially unobjectionable, and that will stifle that part which is not.

The phrase "free competition" does not signify, therefore, as some influential persons seem to assume, a battle royal in which there are no rules and the devil takes the hindmost. If "rugged individualism" is to be praised, the phrase surely cannot mean that every individual should be free to exert whatever powers he may happen to have, in whatever ways he pleases, and for whatever ends he may set himself, unless, indeed, our object is to establish the law and condition of the jungle.

We must first define the ends that shall be legitimate, and the means by which they may lawfully be attained, before we can permit individuals to go to their objectives, within the established

is practically impossible. Such societies are, in fact, marked by the most ruthless tyranny. Free contract, on a pecuniary basis, is the only practicable means of attaining an automatic distribution of the fruits of individualistically determined production, and of avoiding the arbitrary exertion of power in the organization of the work and the distribution of the income, of any society which has abandoned the method of self-sufficient individual productive units.

rules, with all the force that they can bring to bear. The object and the rules of the "game" must be laid down. This involves not only a judgment of values by which ends may be determined but also the establishment of a milieu favorable to the attainment of those ends. "Interference" by government is here indispensable. *Laissez-faire* has no tolerable meaning other than this: that whatever rules are laid down should be of general rather than special application and that, given the general rules and adherence thereto, the "game" shall thereafter be left to the players undisturbed. It is most unlikely, however, that, as circumstances change, an unchanged set of rules will promote given ends.<sup>29</sup>

To cry out indiscriminately against *all* innovations in government activity is, therefore, the essence of superficiality. Every such innovation must be judged on its merits as furthering or retarding the attainment of the conditions under which individuals may freely compete.<sup>30</sup>

In an invidious display of talents, mental and moral juveniles will tolerate and even invite competition which they feel they can readily overcome, but they will be quite as ready to crush, with almost any tactics, that which they cannot hope, in a fair field, to surpass. To keep competition from sinking to ever lower levels, until the bottom is reached, it is therefore necessary to *enforce* restraining rules. It is just as naive to suppose that "free competition," if ever established, would maintain itself, as it is to imagine that political anarchy will provide perfect social freedom. The economic world needs policing fully as much as its political counterpart and the failure to provide adequate policing has led inevitably to industrial tyranny.

Free competition, in the technical sense, means competition on a high level but high-level competition shares in some measure the characteristics of the Christian graces in that, so far as it is not universal, it is likely to have some perverse effects. Those who can put themselves outside its range may be able to exploit those within,

<sup>29</sup> It is an essential function of government to determine, from time to time, precisely what forms of assertion of individual power are in the social interest, or are a matter of indifference to the group as a whole, and what forms the state, representing the general interest, must suppress.

<sup>30</sup> If we never changed the rules "in the middle of the game" we would never change them at all. The game of life is unlike other games in that it cannot be divided into discontinuous periods.



and arrogate to themselves unearned income, *in the degree in which their situation approaches uniqueness*. Equity may, in short, be better served by a wider than by a narrower deviation from the ideal. This merely means, however, that the devil must be fought with fire, that the battle must be carried on simultaneously and with equal pressure on the whole front, and that illegitimate power otherwise exploitable in a private interest may be in part nullified by other private power as well as curbed through the exercise of social control.

#### APPROACH TO SOCIAL GOALS AND THE RETROGRESSION

Throughout the nineteenth and the early part of the twentieth centuries a colorable approximation to a politically classless society was in process of development over a great part of the world, but the growing equality of political opportunity was in the later years accompanied by a progressive increase in the inequality of economic opportunity. This inequality of economic opportunity was marked by impotence rather than overt oppression—that is to say, power was not so much perverted as throttled. True economic power can, as noted, be expressed only in production, but production was deliberately curtailed in manifold ways. It became customary in the United States, for instance, to:

1. Destroy "surplus" commodities.
2. Impose, or at least induce, restrictions on the planting of crops and the raising of animals.
3. Curtail the output of most mineral raw materials and manufactured goods.
4. Limit the amount of work a man was permitted to do, regardless of his capacity or inclination.
5. Force the employment of wholly superfluous "labor" or, at any rate, compel payment therefor.
6. Prevent workers from doing even the simplest task outside their rigidly defined specialties.
7. "Soldier" on the job with the idea of making it last as long as possible.
8. Restrict instruction in productive techniques and impose unnecessarily lengthy apprenticeships.
9. Use labor lavishly on governmental projects and proscribe the employment of technically superior methods.

10. "Boondoggle"—that is, seek means of engaging the activity of part of the population in such a way as not, by any chance, to produce what people really wanted.

11. Countenance, and even embrace, disaster, in welcoming the preparation for, or conduct of, a "good-sized war" as a means of escape from economic stagnation.

12. Urge the most reckless investment as indispensable to keeping the productive machine running.

13. Forget that the sole social reason for exports is the acquisition of imports and, in consequence, endeavor to expand exports and contract imports on the ground that this would make more work for the home population though it obviously diminished the supply of goods available to it.

14. Accept, in payment for the excess of exports, a batch of promises that were, *at best*, of dubious virtue, or gold, which was perhaps the one good of which the country had no further need.

15. Expand, at feverish haste and at constantly increasing real cost, the output of gold to add to a not only redundant but positively menacing stock.

16. Put barriers in the way of interstate commerce in defiance of constitutional provisions formulated at a time when insight into the true ends of economic activity, and into the appropriate means for realizing them, was much less clouded than it now is.

17. Suffer a miserly hoarding of money, or claims to money, rather than promote investment in potentially more profitable equities in real wealth.

18. Praise, as a reflex to hoarding, such conspicuous consumption as ostentatious debutante parties and the like, and hail what, on grounds of common sense, must be regarded as the disasters of fire, flood, and drouth, because they make work (but not, be it noted, bread) for the population as a whole.

19. Go in for more or less permanently unbalanced governmental budgets and, tacitly or expressly, accede to the proposition that debt is the road to recovery.

20. Flout the "instinct of workmanship" and encourage contentment with parasitism.

21. Cast aspersions on the economic virtues of thrift, self-reliance, and indefatigable industry.

22. Make profits rather than prosperity the criterion of economic health.

23. Accept as inevitable a malarial economic condition with alternate fevers and chills and more or less persistent lassitude.

24. Keep large numbers unemployed and regard as "normal" a level of output far below that which was demonstrably attainable.

#### SOCIAL PLANNING

This is a picture of a very sick economic system. A change very much for the worse in the setting for social goals had been subtly effected. No individual, or group, was primarily responsible for the disease but nearly all had participated in practices under which the general welfare was persistently flouted. As may have been noted, in the list of economic follies given above, the entrepreneurial "class," labor organizations, and even government under the instigation of one or the other of the two former groups, have all indulged a preference for a part, to the detriment of the whole, of the social body, and all the members of that body finally suffered, in unequal degree, for the sins of each. In the struggle of each to secure a larger share of a product which was persistently and at times spectacularly diminished by their conflict, all were victims of a set of institutions which had gradually been perverted from their original and rational purpose and had in due course become completely imbecile. Private power had coagulated in the hands of "pressure" groups engaged in mutual frustration—the diffusion of power necessary to prevent its exertion to antisocial ends had been lost—while government was blind to the principles on which alone it could confine the expression of power to socially legitimate purposes, release the productive energies of its citizens, and preserve their freedom.

The situation at length became so grave that half-measures were clearly inadequate and escape was more and more sought in a totalitarian synthesis of power which, whatever its dangers, could at least produce a semblance of order and efficiency.

There has been a strong tendency toward totalitarianism everywhere and, in some countries, it has been carried to its logical conclusion. It is called planning, which sounds scientific. But planning calls for blueprints, blueprints must be followed if they are not to be completely futile, and recalcitrants must be "brought into

line." This is the open door to the old, well-trod, and thoroughly discredited way of force in the organization of production. In short, it means shooting. The general freedom may not be greatly impaired, or even impaired at all, by general prohibitions (some such prohibitions are essential to social freedom), or by conditional restraints, but it quickly vanishes as positive obligations are extended. Prohibitions may leave a wide variety of choice; positive commands leave none.

The more specific the plan the more of a strait jacket it becomes. The only social planning compatible with the realization of social goals is the planning merely of a frame of reference, "rules of the game," which will leave the "players" the fullest scope for choice. Social planning must always hold coercion to a minimum. Order can be established by force, and order is indispensable to power, but, though there is order in a prison, this does not make it a model for the organization of the community at large. Detailed planning is essential to the exercise of the full powers of an individual but it becomes futile if he must walk a path closely prescribed for him by omnipotent authority. Such planning by the state negates planning by the individual and, as it exalts the state, inevitably depraves its members.

#### DESPERATE DIAGNOSIS

Desperate diseases may call for desperate remedies but not for poison. The disease, in fact, is not as desperate as it has, in some quarters, been diagnosed to be. We have been suffering from two opposing errors of pessimism—"the pessimism of the revolutionaries who think that things are so bad that nothing can save us but violent change, and the pessimism of the reactionaries who consider the balance of our economic and social life so precarious that we must risk no experiments."<sup>31</sup> The latter of these pessimisms has been the principal factor in the occasional sweeping victory of the former. A readiness for reform is indispensable to the averting of the revolution which threatens to engulf us in a new Dark Age.

The social changes which marked the first half of the nineteenth century were in the line of progress. That progress was checked,

<sup>31</sup> J. M. Keynes, *Essays in Persuasion* (Harcourt, Brace and Company, New York, 1932), pp. 359-360.

yet the remedy lies not in an abandonment, but in the fuller realization, of the principles on which it rested.

No question will ever be settled rationally if it can be "settled" through the exercise of primitive power by men who have the will and ability to domineer. An impasse, with a balance of forces, presents, however, a situation in which reason may come to power. Those who might have provided a rational rather than a violent solution of modern economic problems had unfortunately gone in the frivolous pursuit of irrelevant gods. We have had specialists in economics, and specialists in politics, but few who have seared their scientific souls with political economy.

#### NEITHER DEADLOCK NOR THE IRON HAND

If we are to be the masters rather than the slaves of our economic institutions, we must see to it that they are such as to prevent both the frustration of power and its conversion to predatory use.

The essential for the *development* of social power in the economic sphere is that there be no inhibitions on the incentive to the individual to exercise economic (that is to say, productive) power, and that no individual shall fail to lose power by refraining from, or obstructing, production. The essential for the *attainment of freedom* is the preeminence of productive over any other power and a balance rather than a concentration of power in general.

To neglect either of these essentials is to invite disaster in the quest for the realization of social goals. The one has, however, been spurned in the societies which still make a show of freedom and the other in those which affect to scorn it.

The remainder of this book reviews our economic institutions with an eye to the maintenance of both of the essentials to social progress. The two immediately succeeding chapters are addressed to a discussion of the causes and prevention of the frustration of economic power in the "plutocratic" world, while those which follow are concerned with the appropriate distribution of the fruits of an uninhibited productive system. It will then be clear that economic matters, like other results of human volition, are mainly determined by the struggle for, the forms, the location, and the regulation of power and that a satisfactory economic system rests on the continuous advance of power-*cum*-freedom.

**PART II • ECONOMIC INSTITUTIONS:  
THE RELEASE OF POWER**



## CHAPTER IV

### PROFITS

#### THE "NATURALNESS" OF PROFITS

PROFITS is the key to the release of economic power in a volitional economic system. The universal desires both to retain and to expand power are present in different men in very different relative strengths. This fact is nowhere better illustrated than in the organization of free enterprise under which the individual's role is freely chosen according to personal ability and inclination. Some form of profit system is the all but inevitable outcome.<sup>1</sup> Those in whom the desire for expansion of power is relatively strong will be comparatively eager to take the risks that, under free competition, are associated with profits; those who prefer security of their present power to any sharp expansion of it will be reluctant to assume such risks.<sup>2</sup> General economic freedom consists in keeping the way to enterprise open to those who are

<sup>1</sup> Probably no concept in the whole of economic doctrine has more shades of meaning than that of profits. As conceived here it is to be understood functionally: first, it is a residual return to entrepreneurship, differing from the other factoral returns in that it is not contractually determined; second, being residual, profit is that share of income which bears the burden of risk; third, profit, as the *causal* or dynamic factor in the competitive system, is that anticipation of a general rate of return on productive enterprise which is just sufficient to induce enterprisers to undertake the risk and responsibilities of production. Profits, as understood here, is thus a heterogeneous category more akin to the concept of the classical economists (who included, in the term, interest, wages of management, and compensation, if any, for the assumption of risk) than to the neo-classical idea of "pure profit," which is exclusively associated with income arising out of the element of indeterminacy in economic relationships. It is the accounting, rather than any more esoteric, concept of profits, on which attention will be centered.

The phrase, "the profit system," is somewhat misleading in that it conveys the idea of privilege. A better designation would be the profit-and-loss system inasmuch as losses are fully as germane to it as profits. Since profits, in a system of free enterprise, have losses as their inevitable counterpart, cooperative activity, with the idea of eliminating profit, is seldom successful except in relatively safe business pursuits. Few "cooperators" bear losses cheerfully but losses are, *ipso facto*, inseparable from risk-taking.

<sup>2</sup> If, as is alleged, the great majority of humankind desires to be dominated, this would seem to be merely a strong aversion to the assumption of responsibility, i.e. risk. It may be well to repeat that no one desires to be dominated without a *quid pro quo* in safety or some other such consideration, and that no one likes to have the possibility of withdrawal from a domination, to which he may for the time being willingly submit, taken from him.



inclined to take risks and the way to employment open to those who are not—in both cases on equitable terms.

The easy emergence of a wage and salary proletariat, whenever general conditions favor this mode of production, is attributable, at least in part, to the more or less general and persistent preference for a steady, presumptively assured, contractual reward in directed work as against an uncertain (even if larger average) income arising from the irksome assumption of responsibility, alertness to more or less unpredictable change, and the frequently recurrent requirement of fateful decision which, under free competition, is the lot of the typical enterpriser.<sup>3</sup>

#### GROWING CONCENTRATION OF RISK

The increasing tendency to contract out of responsibility, leaving to the enterpriser alone the residual sum from the gross takings of the enterprise, operates to concentrate ever more fully upon him all the changes, irregularities, and fluctuations of economic life. He becomes the shock-absorbing buffer of the economic system. With the growth in the size of productive units the total number of active enterprisers has become an ever smaller proportion of the gainfully employed population and, whatever its trend, the enterpriser's share of the aggregate income has always been a minor percentage of the whole. The fluctuations in profits running from high positive to perhaps equally high negative returns (losses)—particularly marked when the aggregate income of the community shows large variations—are now, in consequence, very great. Profit is, indeed, *the* form of income of which wide fluctuations are typical and this is true not only as between individual enterprisers but also, and more significantly, as between enterprisers as a whole and other sectors of the population. No other sector of the population, as a whole, ever receives a pecuniarily negative return, but this is not uncommon for enterprisers not only as individuals but even as a group.<sup>4</sup>

<sup>3</sup> Even in farming, almost the last stronghold of the small enterpriser responsible, as an individual, for the success of his undertaking, there is a noticeable drift toward a form of the wage system. A good many farmers now grow their crops under direction and sell their output to an enterpriser at prices fixed in advance. It is said that the desire to do so is increasing.

<sup>4</sup> The tendency to contract out of risk is as strongly operative in the field of capital as in that of labor. In evidence thereof we may note the relative growth of

## EVASION OF RISK BY "ENTERPRISERS"

Now enterprisers are not made of entirely different stuff from the rest of humankind. They merely possess certain characteristics in greater, and others in less, degree than their fellows. They do not like risks as such but rather the power which goes with their successful assumption. It is not surprising, therefore, that, in common with the generality of mankind, they have sought, so far as possible, to avoid risks which must somehow be borne. In theory it is their function to be the sole bearers of this responsibility; they are the self-elected assumers of it. In practice, however, the burden has proved so great, as a result of our failure to develop or maintain the appropriate institutional framework, that enterprisers have taken every opportunity afforded by the current institutional situation to shift to others a substantial part of the risk they are supposed to assume.<sup>5</sup> They have sought power without responsibility and the perversion of our institutions has enabled them to obtain it.

The wage-earning group has been the legatee of much of this inappropriate shifting of responsibility since the discharge of workers is an early entrepreneurial response to losses. The wage contract, abstractly considered, is not unlike that between the feudal "man" and his lord, in which, in exchange for protection and sustenance provided by the lord, the "man" furnished the lord with the services the latter desired. The essence of the wage contract is a similar offer, by the employer to the employee, of a steady sustenance, with protection against the aberrations that mark a non-contractual return, in exchange for services which may possibly, and even probably, yield a greater value, on the average, than is paid for them. The more or less steady sustenance and the

the volume of securities bearing a contractually fixed rate of interest to the total capital funds employed in industry. Private long-term debt grew by some 300 per cent in the period 1913-1929. cf. Evans Clark, *Internal Debts of the United States* (The Macmillan Company, New York, 1933), pp. 10, 13.

<sup>5</sup> This is true of nearly all businessmen, large or small. The small fry hanker after price-fixing under some "czar," of their own choosing, and the big establish cartels. The quest of businessmen for monopoly power is of immemorial antiquity and constancy. It reached its zenith, perhaps, in the later Middle Ages when the various guilds had brought almost everything under control, at "just" prices, but the Middle Ages are being challenged in this, as in other respects by developments in the most recent times. •

more or less assured protection attained by the feudal "man" is implied in the modern wage-contract and, in an economic order of the equilibrium type assumed by the classical economists, the worker would achieve its substantial realization.<sup>6</sup> But, in the chaotic economic order which has in fact developed, the "risk-takers," instead of assuming the enormous, if not intolerable, losses which they believe would attend the maintenance of their full labor-force in times of stress, have thrust them on the workers or on society at large. They have acquired the privileges of the lord of the manor but have divested themselves of his obligations. The "independent" worker, on his part, has sold his birthright for a sour mess of the pottage of illusory security. Except in a condition of persistent full employment—the consummation of the right to a job—the wage system loses all social justification.<sup>7</sup>

#### THE ROLE OF LOSSES

The counterpart of profits is losses. In a system of free enterprise, in an inevitably uncertain world, losses, to some enterprisers, are socially salutary as well as certain. The economic function of such losses as the counterpart of profits is threefold: (1) to adjust supply to evolving demand through a penalty on those who have misjudged the trend of demand and indulged in relative oversupply of comparatively undesired commodities or services, (2) to eliminate the unfit, that is the inefficient, producers of *any* commodity, and transfer their business to their economic betters, and (3) to effect a distribution of risk on a voluntary rather than an arbitrary basis. Losses are thus an inherent feature of a system of free enterprise, and profits not countered by losses can be generally acquired only as a result of special privilege. If enterprisers did not take the chance of losses they would never be entitled to any return beyond pure interest and wages of management. If they

<sup>6</sup> Protection is implied in the contract but not expressed. The contract covers only a short period, often only a day, or does not mention the duration of the agreement at all and, while it is assumed by both parties that it will last indefinitely, there is no legal obligation on the employer to provide work or sustenance. The employee, of course, is also free to quit when he pleases but this is, at present, merely a formal and no real counterpart of the employer's right to discharge.

<sup>7</sup> The provider of capital, who seeks to contract out of risk by taking a comparatively low return on securities with a fixed and presumably uninterrupted rate of interest, has, in his search for security, been only slightly more successful than the worker.

seek more than this they must, under free competition, risk the loss even of these.<sup>8</sup>

Industrial progress inevitably causes obsolescence. Under free competition, this obsolescence will result in the failure of some of the firms affected. It is of supreme importance, as a condition of advance, that pressure of this sort be great and losses frequent. A rather high failure rate is, therefore, to be regarded as a normal accompaniment of kinetic conditions. It is, however, a primary aim of financial, as contrasted with industrial, enterprise to thwart this process and to preserve the value of well capitalized interests. The method adopted is to promote a monopoly through the consolidation, under a single financial control, of enterprises shaken by technological developments or by changes in demand or in optimum location. The merged concerns can then successfully resist technically desirable readjustments or can, at any rate, protect obsolescence until the obsolete equipment becomes completely worn out and is not replaced *in situ non grato*. This means an at least negatively unproductive use of resources. Once monopoly is in this way established, moreover, it is a short and easy step to exploitation of consumers so that, in spite of the obsolescence, increased profits, quite unassociated with economic merit, can be extracted from the situation. Firms in this position of socially objectionable power will, furthermore, all but certainly practice the positive restriction of output which is the characteristic of monopoly, though they may be unable to prevent newcomers from breaking into the field if the monopoly is "imperfect." An oligopolistic situation is then set up, with an undue expansion of fixed investment and consequent unemployment of equipment. Instead of cutting prices, and so keeping up employment of labor, such firms will then react to any drop in demand by reducing output still further and discharging many of such laborers as they had hitherto employed. Their watchword is maintenance of prices, re-

<sup>8</sup> In recent decades the feeling has grown up that "enterprisers" are entitled to profits. This, of course, is not the case. They are entitled only to the *opportunity* of profits, if they will assume the risk of losses. Yet we have had many cases in connection with armament orders in which so-called enterprisers would not move without a *guarantee* of profits, and this when the chance of profits was exceptionally good. It is very significant of the perversion of the system that their attitude was generally regarded as not unreasonable. It should be said, however, that our peculiar system of taxation partially justifies the "enterprisers'" attitude.

gardless of the effect on the demand for goods and, therefore, workers. The elimination of free competition makes this a feasible program.

#### NECESSITY OF A FAIR PROSPECT FOR PROFITS IN GENERAL

Even though, under free competition, the way of enterprise must inevitably be risky, the first requirement of a satisfactory working of the economic system is, nevertheless, the steady maintenance of the *general level* of profit prospects, in the economy as a whole, at a height sufficient to induce enterprise in volume adequate to provide full employment.<sup>9</sup> There should, at one and the same time, be a steady prospect for profits, in the economy as a whole, without any presumption of profits, rather than losses, to any individual enterpriser, especially those of merely marginal competence. This can be attained only with fluctuating price relationships *within* a stable price level. Since, with a given technology, the income and general economic welfare of a people is entirely bound up with the volume of (appropriately distributed) employment, and since this volume will depend on the current incentive to enterprise, the necessity for steadiness in the prospect of profits as a whole is of the most compelling urgency. The general level of profits, however, instead of being stable, as the proper working of the system requires, is in fact just the opposite. General profits, and the prospects thereof, quite inappropriately partake of the instability

<sup>9</sup> The prospect for profits as a whole must, that is, be good enough to overcome whatever reluctance to assume risk is found in the least eager enterprisers at the point where all non-enterprisers are employed. In orthodox economic literature the problem of the general level of profit prospects was wholly ignored—the profitability of enterprise in general was taken for granted. In his attack on this optimism Mr. J. M. Keynes, *The General Theory of Employment, Interest and Money* (Harcourt, Brace and Company, New York, 1936), employs the unhappy analytical concept of the marginal efficiency of capital. The concept of the general level of profit-prospects, though lacking the illusory elegance of Keynes's marginal construction, would seem to be more in harmony with the facts of a real world in which all enterprise is undertaken on anticipations that are founded, inevitably, on nothing more solid than very rough guesses about dimly limned alternatives. Uncertainty, in the past at least, has been so great that there has been no scope for the application of a scale of probabilities, and the attempt to lay down a scientific (that is to say, measurable) criterion for enterprise is a presumptuous essay in futility. It is, indeed, excluded by definition since anything that can be taken out of the realm of complete uncertainty, and subsumed in a scale of probabilities, is insurable, and therefore a matter not of enterprise but of mere administration.

which rightly characterizes the returns to individual enterprisers.

Non-entrepreneurial incomes are, typically, fixed by substantially irrevocable contract but profits is the residue, if any, of a gross entrepreneurial income against which these fixed costs are chargeable. The result is that the prospect for profits as a whole can be steady only if gross entrepreneurial (i.e. total) income is stable. Under existing institutions a vicious circle develops in that profits as a whole are unstable because total income is unstable and total income fluctuates because the prospect for profits is variable and the enthusiasm for enterprise shows, therefore, marked vicissitudes. Unless we can devise a means for stabilizing aggregate profits, at the appropriate level, the system of free enterprise cannot do better than stagger toward its goals even if it succeeds in moving at all in that direction. Under it, there can be no stability of employment, and therefore no real freedom, without stability in the general flow of profits; but on the other hand there can be no stability in the general flow of profits without stable employment. The two things are indissolubly tied together.

#### ECONOMIC EVOLUTION FAVORABLE TO STABILITY IN THE PROSPECT FOR PROFITS

Total production, in the modern world, is subject to a much reduced inherent hazard of fluctuations. When, as in times not long past, the bulk of output was agricultural, very great vicissitudes in the volume of real income were inevitable. The fate of the enterpriser in any given year was then largely in the hands of what must have seemed to him a very capricious God. No one could with any accuracy foresee what the result of the employment of a given volume and composition of resources would be. For the larger part of production nowadays, however, there is no such hazard, and a rather precise foreknowledge of the physical yield from the full employment of a given volume and composition of resources is possible. The total real income issuing from full employment of the population of an industrial society in a given state of the industrial arts would now, therefore, be substantially constant over short periods and, since technological improvements taken as a whole proceed at a rather even pace, there is no inherent reason why the element of constancy could not be maintained in an even rate of progress. With costs, at any given moment, con-

tractually fixed at a level which would induce an optimum volume of enterprise, the general prospect of profits could then be stable provided the general level of prices remained unchanged. Stability in the prospect of profits would, in turn, keep employment at optimum level.<sup>10</sup>

The risks, then, that enterprisers as a whole must take have been *in posse* reduced as industrialization has developed. One might, therefore, have expected a greater readiness for enterprise. This has not, in fact, appeared, in part because a quasi-monopoly of entrepreneurial functions has been established (with the road blocked to newcomers and the insiders under no strong pressure to take risks) but more significantly because our pecuniary mechanism has thrust huge and quite needless uncertainties on enterprisers. Here again a vicious circle has arisen. The failure to establish the conditions under which freely competitive enterprise could flourish has led to the growth of monopolies and the growth of monopolies has not only been an invasion, *per se*, of the field of free enterprise but has aggravated the ills under which all enterprise has been prostrated.

#### STABILITY IN GENERAL PROFIT PROSPECTS MORE IMPORTANT THAN HIGH PROFITS

In "normalized" industries, where changes in the methods of production are slow, the rewards for enterprise, under free competition and persistent full employment, would be small in proportion with risks. Gross profits would here tend to be no greater than a return to cover wages of management, interest on capital whether invested on a bonded or equity basis, and perhaps a very minor compensation for the slight risks taken by reasonably competent enterprisers.

In relatively uncharted fields, however, where risks are inevitably great because there is no specific experience on which to rely,

<sup>10</sup> Some writers would assert that a free economy is *inherently* unstable as a result of self-inflamatory structural dislocations almost certain to develop in the interrelationship between consumption, investment, and income. cf. Clarence D. Long, *Building Cycles and the Theory of Investment* (Princeton University Press, Princeton, N.J., 1940), chaps. II and III. The possibility, even the probability, of such dislocations under existing conditions may be readily granted. But Long does not maintain that they are inevitable and, under the proposal made in the next chapter for automatic investment whenever consumption declines, they would be subject to steady elimination both in the short and in the long run.

one might suppose that a large return must be in prospect to successful risk-takers in order to induce them to assume the responsibility of undertaking enterprise. It would, however, be a mistake to assume that this is necessarily the case. Much depends upon the types of risk assumed and the types of possible reward. In some cases risks will be undertaken without either stability in the prospects for profit or an average high return. There is a widespread predilection for the risking of a small loss on ventures which offer a disproportionately small chance of a large reward—that is to say, on ventures where the presumptive losses are diffused and the potential gains concentrated. Herein lies the lure of lotteries, even when the participants know that their actuarial chances of gain are negative. Men will not hesitate to enter a lottery, which offers large prizes to the lucky few, even under the knowledge that their chance for a prize of any given amount is smaller than the proportion which the price of the chance bears to the aggregate sale price of the tickets. This means that men not only do not have to be paid for assuming this type of risk but that they will actually pay for the opportunity. We must presume that, under conditions of free competition in economic life, analogous risks are taken, without any net payment to the enterprisers, that there is a net entrepreneurial loss in such lines, and that, even so, enterprise will here always rise from its ashes.<sup>11</sup>

The risk of even small losses will not be undertaken nearly so readily when the prospect is that success will be crowned by correspondingly small gains, that is, when there is diffusion both of presumptive losses and potential gains. It is probable, therefore, that the prospect of a net return must be fairly good to induce enterprisers to assume this type of risk.

A good prospect for profits is even more necessary in industries where losses may be severe and gains are likely to be moderate. Such are the industries which call for capital investment heavy in relation to annual turnover, and it is these industries which are typical in a modern economy. It does not follow, however, that aggregate (net) profits must in these lines be very high. Compe-

<sup>11</sup> Highly aleatory enterprises never lack participants. The most obvious case is low-cost prospecting, but one might cite the constant attempts, in the face of repeated failures, at producing a dramatic "hit," or the launching of fliers in the field of "popular" magazines. .



tent producers will be more readily stimulated to activity by a greater steadiness in the prospect for merely moderate profits than by potentially great but very uncertain profits coupled with a first-rate chance of complete ruin. They will, in fact, be much more concerned about the possibility of losing their large investment than with possible bonanzas. Stability is here of supreme importance. The desideratum is not very large profits so much as steadiness, and especially the avoidance of losses.

The fact is that the needless risks associated with our present economic institutions have been especially prominent in impelling producers in these lines to get rid of competition so that they could do something to stabilize their own situation and protect their investment under any circumstances.<sup>12</sup>

#### MONOPOLY AS THE OUTCOME OF THE QUEST FOR STABILITY

Monopoloidal industries are in a position to adjust their output so as to obtain prices which will secure them against loss except in the very stormiest times. The risks that must be assumed by newcomers, outside the pale, in ruthless competition with industrial giants are so great as all but completely to preclude their entry into the field. The favored position of the monopoloid industries is therefore practically unassailable; the average profits which they secure, to say nothing of those which more efficient competitors would secure if they could count on the maintenance of the existing sales prices for the product concerned, are high enough to attract keen competition if it were not next to certain that the already established firms would slash sales prices of the product for a period lengthy enough to inflict intolerable losses on temerarious parvenus. Such losses involve not only the difference between

<sup>12</sup> "There can hardly be any doubt that periods of heavy trade depressions were especially instrumental in fostering the cartel movement . . . and we may observe the peculiar phenomenon that in periods of upward cyclical movements, genuine and free competition often exists in an industry which turns during a depression period to open or secret agreements in order to check the adverse effects of contracting markets." cf. Karl Pribram, *Cartel Problems* (The Brookings Institution, Washington, 1935), p. 21. This statement corroborates the oft quoted saying "Kartelle sind Kinder der Not," attributed to August Thyssen. In periods of depression, competition is likely to be of the cutthroat variety, from which release is sought in a cartel. It sometimes happens that the breakdown of mere informal agreements, under the weight of depression, leads to conditions out of which cartels readily grow.

the prime costs and the reduced selling price of the product but jeopardize the whole cost of the investment, since the salvage value of fixed and specialized equipment, for which the only probable buyers are victorious rivals of the necessitous sellers, is next to negligible.

Established monopoloidal firms have thus, in reality, acquired the position of state industries in that they can preclude losses to themselves by thrusting the burden of their mistakes and inefficiency, as well as that of generally adverse circumstance, upon a public which must buy the products, if at all, at prices satisfactory to the producers. So far as the public refrains from buying the products at these prices the concerns affected can always reduce their outlays by discharging workers (to be supported by the community) without much danger that they will lose any part of such business as is done, in their field, now or in the future. Existing small competitors may be permitted to undercut the dominant concerns in a minor degree since, even when they are operating at capacity, they are not equipped to handle very much business, but they cannot risk new capital investment when the prospects of profits to them are currently not very favorable and prospectively are worse. The chances of cutthroat competition, in which the small producers would be early victims, are so strong that the small producers ordinarily refrain from the reductions of price which would initiate it.<sup>13</sup> The position of the dominant concerns is in many cases fortified, moreover, by the feeling of buyers, especially of durable goods, that they must deal with a firm (usually monopoloid) on which they know they can rely. No buyer wants to be left with an "orphan" product on his hands.

The result of this whole situation is that monopoloidal firms, without really assuming any substantial risk or indulging in bold enterprise, can frequently secure those large returns which are appropriate only to successful risk-taking of the type in which heavy potential losses are associated with the prospect of merely moderate gains, or, even if they are markedly inefficient, can main-

<sup>13</sup> It should be noted, however, that not only do many small firms operate under a price "umbrella" which the big firms hold up, without any goodwill toward the little fellows who sneak beneath its protection, but a livelier small-scale competition is also maintained, against big firms who are not in a position to exert full monopoloidal power, through various forms of "scalping." Fortunately, for society at large, competition has the characteristics of the Phoenix.

tain themselves in business indefinitely and obtain, if not earn, a "satisfactory" rate of profit.

STABILITY IN PROFITS OF MONOPOLOIDAL INDUSTRIES  
AT THE EXPENSE OF INDUSTRY IN GENERAL

When, however, in a condition of unemployment, the total income of the community is reduced, and the returns to enterprise as a whole decline (both absolutely and in relation to the comparatively fixed shares of other factors in production), the ability of any one group of enterprisers partially to avert the incidence of the depression inevitably increases the burden of loss upon their less fortunately placed fellows. It is not surprising, therefore, that the high average rate of profits, over the years, which monopoloidal business can show is accompanied by a strong tendency toward losses in other branches of industry.<sup>14</sup>

If losses are the general lot of those who enter lines of business where entry is substantially free, while profits are more or less closely confined to businesses to which entry is difficult, enterprise will surely languish.

There is thus no doubt that the prevalence of monopolies, duopolies, or oligopolies (all of which are in a position in some measure to protect themselves from the results both of their own inefficiency and of the general instability of which they are in part a cause) is an evil of great magnitude. The more important inhibitions on enterprise, however, are not attributable to the monopoloidal element as such but are a reflex from the ability of monopoloidal firms to secure for themselves relative stability in an

<sup>14</sup> cf. E. D. Kennedy, *Dividends to Pay* (Reynal and Hitchcock, New York, 1939), *passim*. The standard book on profits in the United States is Ralph C. Epstein's *Industrial Profits in the United States* (National Bureau of Economic Research, New York, 1934). Professor Epstein shows that, for the decade 1919-1928, the very large corporations were by no means the most profitable, so far, at least, as the records indicate. This would seem to be strong evidence of the economic inefficiency of great size rather than of the failure of the largest corporations to obtain monopoloidal powers. By trade marks, and other means of differentiation of products from substantially identical wares marketed without such *business* advantages, medium-size corporations can, moreover, frequently secure monopoloidal positions without running into the inefficiency which is likely to characterize an outright monopoly. Professor Epstein's study, unlike that of Mr. Kennedy, does not cover the years of severe depression, in the early '30's, which seem to have shown decisively the relative vulnerability of small-scale and strictly competitive business.

unstable economy. The more stable, relatively, they can make their own situation the greater the disturbance they thrust upon the remainder of the economy and, in this instability, even their own (absolute) position is adversely affected. If, however, stability in the economy at large could be attained, the presence of monopoloidal firms would, perhaps, not be of extremely noxious import, while the stimulus to their formation would be very much weakened.

#### PREFERENCE FOR LIQUIDITY THE FUNDAMENTAL EVIL

The *principal* cause of the social failure to use human resources fully is not to be attributed to monopolies as such.<sup>15</sup> In a pecuniary society, the source not only of power but also of the means of entrepreneurial survival is not so much productive efficiency as liquidity. A general desire for liquidity, as things now are, lowers the prospect for profits and strangles production. It is not only when the preference for liquidity rises sharply that the difficulty is felt. The menace is practically always in the offing except in what, it may be hoped, are still the abnormal conditions of war, preparation for war, or inflation. That is to say, it is present except when the demand for goods is of the most compelling urgency or when money ceases to fulfill one of its principal functions as a bearer of options. The upshot is, in normal times, a cutthroat competition in which profits tend to disappear, at least for all firms which are not in a position to temper the wind of deflation.

The great paradox of the system of free enterprise under existing institutions is that it works normally—in the sense of full employment—only under abnormal conditions. In nearly all such abnormal conditions inflation of some type is involved and this has led many “observers” to the belief that without inflation the productive system does not generate sufficient purchasing power to permit the profitable sale of its output.

#### ADEQUACY OF PURCHASING POWER

That there is no inherent lack of pecuniary purchasing power for all the goods produced is apparent when we recall that money

<sup>15</sup> This is not to say that monopolies are not an important contributing factor or that they do not seriously affect the distribution, as compared with the emergence, of the social product. Any private power, other than pure productive power, is always a menace to freedom.

costs of production<sup>16</sup> are, at all times, money incomes to the recipients.<sup>17</sup> Aggregate money costs and money incomes in the productive process must therefore always be equal. This is true whether we think in gross or net terms. The total amount of payments laid out in the productive process, and the total of gross entrepreneurial incomes, is, of course, many times the value of the final goods produced. This follows from the fact of division of labor. The relation of gross to net costs and incomes is purely a function of specialization. If a single firm produced any final commodity, from the ground to the consumer,<sup>18</sup> gross costs and incomes would also be net costs and incomes. But where production is specialized, the gross outlays (costs) of any producer after the initial stage, and therefore the gross incomes of the recipients of these outlays, will greatly exceed the net. At any of the later stages of specialized production, money will be paid out for a partially produced good, to be further processed, and will be recouped by the enterpriser, together with his net costs of processing, through a sale to the producer in the next stage and, finally, to the consumer who has been the recipient, directly or indirectly, of some enterpriser's cost of production. But each gross outlay is the sum of only the preceding and concurrent *net* costs and is, of course, income to somebody. If, for example, there be five stages of production, and the costs of the primary raw material and of processing in the several stages be designated *a, b, c, d, e*, respectively, then gross outlays and incomes will be  $a + (a + b) + (a + b + c) + (a + b + c + d) + (a + b + c + d + e)$ , but net outlays, and incomes, will be simply  $a + b + c + d + e$ . The latter will be the price paid by the consumer for the final good which he enjoys. Since an enterpriser at any stage of production will lay out, for his materials, not the sum of the gross costs but merely the sum of the net costs up to that stage, the final consumer will likewise not pay the sum of all the gross costs but merely the

<sup>16</sup> Production is here used widely to cover all types of economic activity involved in the original output of a good or service.

<sup>17</sup> Whether the term "cost" or "income" is used depends solely upon the point of view of the speaker.

<sup>18</sup> Consumer is here, and elsewhere in this chapter, construed broadly to cover the user of all goods which are final in the sense that they do not pass through any further processing, or transportation, before coming into the user's hands. Final goods thus include finished capital goods.

sum of all the net costs involved in the production of the goods he buys.

If production is highly specialized, gross outlays, and incomes, will be many times the net. In the United States, for instance, the volume of business (gross outlays and incomes) is normally many times as large as the net cost of production of final goods, or, what is the same thing, net income. Much of this gross income is never brought to bear on final goods but is spent on raw materials to replace those used up in the production of the good from which the income accrued. But the cost of final goods corresponds with net outlays, and the use of a part of gross purchasing power for raw materials does not, in consequence, inhibit purchases of any existing final good.<sup>19</sup>

Total gross or net money costs of production, then, are inevitably equal, respectively, to total gross or net money incomes. If enterprisers sell their products at a loss, the money cost of their services, like their incomes, is a negative quantity. If, however, as is "normal," enterprisers sell their products at a profit, their profits are the cost of their (presumptive) services which, so to speak, they pay to themselves, and this, when added to other costs, again brings total costs, gross or net, to equality with gross or net incomes.

Enterprisers, in general, can therefore always cover their *contractual* costs (which are their total costs minus their own reward plus depreciation). provided the recipients of contractual incomes spend them, whether for producers' or consumers' goods, as they are received and enterprisers do not add to their own *cash* holdings. Assuming no inflation of the money supply, and no prior accumulation of funds from unexpended earnings, the recipients of money income cannot of course, as a group, spend *current* income faster than it is earned.<sup>20</sup> There is no guarantee, however,

<sup>19</sup> The discussion here is wholly in terms of a long-run equilibrium in which any reserves set aside for contingencies or depreciation just cover user-cost. In addition to the assumption of a constant supply of money, or substitutes therefor, it is assumed that inventories are unchanged, that velocity of circulation of money is constant, and so forth.

<sup>20</sup> Individuals may, through borrowing, spend money faster than it is earned but, in the absence of issues of new money, the lender must then curtail his potential spending correspondingly so that the general rule holds regardless of the volume of such borrowing and lending as does not affect the supply of money.

that they will spend it as fast and, if they fail to do so, the sums accruing to entrepreneurs from sales will not be adequate to cover their contractual outlays already made. This will lead to losses, to a diminution of the enthusiasm for enterprise, and therefore to unemployment.

#### PROFITS SELF-DEPENDENT

Assuming for the moment, however, that the recipients of contractual incomes spend them as earned, enterprisers will, in the aggregate, receive from these expenditures only just enough to cover their contractual costs, with nothing as profit in payment for their own services. A condition of continuing profits to any typical entrepreneur is therefore the receipt and expenditure of profits by *other* entrepreneurs as a supplement to the expenditures of the recipients of contractual incomes and the expenditure of his own current profits. Profits in general are, in consequence, self-dependent and, once they have disappeared, can be restored only by an *ad hoc* injection of money, not currently accompanied by a corresponding volume of goods put upon the market, into the stream of currently utilized purchasing power. This increment of money may come either out of more or less temporary hoards or from an increase in the issue of money by public authorities, private bankers, or both, according to the monetary and banking system in vogue in the jurisdiction in question. So soon as the stream of money currently flowing from any of these sources into expenditures is greater in volume than that currently being paid out by enterprisers on contractual account and for replacements, profits will emerge.<sup>21</sup> If, thereafter, the enterprisers spend their profits, and the receivers of contractual incomes spend their receipts, as they accrue, a profit-bearing situation can last indefinitely and full employment can be maintained without the necessity for the persistence, or repetition, of the injection of new purchasing power.

#### CIRCUIT FLOW OF PURCHASING POWER

The phase of the complex of money circulation which is relevant to the question of employment is the flow through the circuit of new production of goods. Taking as a starting point the initiation

<sup>21</sup> It may be well here to remind the reader that it is assumed that *cash* reserves are not being accumulated by enterprisers as a whole.

of production by enterprisers, the money flow proceeds from the enterprisers to the owners and sellers of factors of production (natural resources, labor, and capital) or the uses thereof, and from these, directly or indirectly, back to the enterprisers through the sale of final goods. And so on in endless repetition. A relatively small supplementary circulation on which, however, the maintenance of the all-important profit depends, is composed of the net income of enterprisers disbursed directly to one another for final goods.

So far as the keeping of the productive process fully in motion is concerned it makes no difference whether the recipients of income spend their receipts on consumers' or on producers' goods, provided production is adapted to demand. With full employment, producers' goods can be obtained only by diverting labor from other industries and, therefore, by reducing the supply of consumers' goods. So long as the recipients of income in the productive process invest it, by expenditure for producers' goods, in the same proportion to the aggregate income of the community as the cost of production of the producers' goods bears to that of the consumers' goods produced, there will be no difficulty in selling all goods at prices satisfactory to enterprisers as a whole. The supply of consumers' goods will, in providing for the producers' goods, be diminished in exactly the same measure as the recipients of income diminish their purchases of consumers' goods in order to invest. The money cost of the supply of producers' goods will thus be exactly covered by the amount of income set aside for their purchase and the money cost of the supply of consumers' goods will be exactly covered by the remainder of income.

After the original provision of capital, sound finance requires that, out of the gross intake of enterprisers, given amounts be set aside to cover contract or other interest on capital, as well as depreciation and depletion of plant and resources. Whether the recipients of interest spend their interest receipts for consumers' or for new capital goods is, per se, of no more importance to the frictionless operation of the economy than is the exercise of the similar alternative by recipients of other income. Amortization or any other kind of reserve funds may not, however, be accumulated coincidentally in *cash* by the generality of enterprisers without provoking a deficiency in entrepreneurial income as a whole.



Ideally, every entrepreneur might, from month to month at longest, spend for replacement an amount exactly equal to the sums he is currently laying aside for that purpose. This, however, is not essential. It will serve to maintain an even keel in the economy if the current excess of amortization or other reserve accumulations of one section of the enterprise of the community is offset by a similar excess of current replacement expenditures over current amortization reserves of the remainder. If, however, they are inadequately offset, the stream of income accruing to enterprisers will, by the amount of the withholdings of current income, be held below the level of current costs. General entrepreneurial losses will then appear and unemployment will occur. The tendency of the managers of business corporations, in good times, to lay aside a cash reserve for "contingencies" may therefore provoke the principal contingency they have in mind.

If, under the assumed conditions of a constant money supply, the production of commodities should increase through an enhancement of efficiency, there would be a tendency for price levels to fall proportionately. There is, however, no reason to suppose that this would necessarily inhibit production. Assuming that money wages and other money outlays remained unchanged, the total money cost of the increased output would be no more than before and would be covered by the aggregate receipts of increased sales at merely proportionately lower prices.<sup>22</sup> A similar, but stronger, conclusion could be drawn if productivity should diminish and prices rise proportionately.

If, however, the aggregate flow of money is checked, trouble ensues, whatever the volume of production. The essential thing is the effective monetary circulation.<sup>23</sup> To keep up a steady emergence of profits, and production therefore going smoothly, it is

<sup>22</sup> Since, with falling prices, the cost of raw materials would decline, many enterprisers might find that their profits were increased rather than diminished. Even if prices should fall more than in proportion to the improvements in efficiency, the consequently reduced profits might furnish to enterprisers the same real income that they had formerly enjoyed.

<sup>23</sup> The man on the street has persistently laid emphasis on "keeping money in circulation" as the condition of prosperity. Orthodox economists, with their eyes on volume of production as the essence of prosperity, have been rather contemptuous of this attitude which seemed to them to exalt the importance of money as against goods. Supported, as it was, with whatever erroneous reasons, the attitude of the layman was nevertheless essentially sound.

essential that the outlay of enterprisers, in both their entrepreneurial and their personal capacity, should flow back to them through the channels of circulation at a no slower rate than that at which it has been, and is currently being, paid out. In the absence of changes in the volume of money, to which attention will later be given, this can occur only if there is a net disbursement of all income at a rate equal to that at which it accrues in the productive process.

#### EDDIES IN THE FLOW

Not only is it irrelevant to the maintenance of industrial activity whether disbursements are for producers' or consumers' goods (provided, at any rate, that the disbursements are in the aggregate apportioned between the two classes of goods in correspondence with their respective production), but it is also irrelevant whether the disbursements are direct or indirect. Innocuous indirect disbursements by recipients of income include (1) gifts of money to individuals who exchange them for goods as rapidly as the donor would have done had he not made the gift, (2) any other transfer of money, without productive *quid pro quo*, and with a similar proviso, (3) the purchase of securities or other claims to future money (commercial and savings bank deposits, insurance, annuities, and the like) provided the seller of the claim, directly or, as is more probable, through some further intermediary, proceeds to the purchase of new final producers' or consumers' goods without any slowing up of the rate of money flow.

The total flow of money is, of course, necessarily greater than the amount required in any short period for the payment of factors of production and the movement of newly produced goods into the hands of consumers. The exchange of old economic goods—land, buildings, all kinds of durable goods including securities, antiques, and second-hand goods in general—calls for money.<sup>24</sup> The buyers divert money from the main stream of production-income but only to have it returned by the sellers. True supplements to income derive only from the output of new goods or services. The remainder of net individual money receipts in a given period

<sup>24</sup> Such exchanges have been called, aptly if egregiously, *post-final* buying. cf. Myra Curtis and Hugh Townshend, *Modern Money* (Harcourt, Brace and Company, New York, 1938), p. 66.

must, so far as exchange is concerned, arise from the sale of physical capital (construed broadly to mean preexisting durable goods, either producers' or consumers'), or claims thereto, and is balanced by the outlay of the buyers of these goods or claims. Such transactions may be regarded as eddies in the money stream, steadily diverting a more or less constant volume of purchasing power from the primary channel but steadily returning a like amount. Once the amount of money is adjusted to a volume sufficient to fill these eddies, at a given level of the primary stream (the height of prices of consumers' goods), the flow of money from and to enterprisers will not be affected if only the eddies disgorge a flow at the same rate at which they receive it.

It makes no necessary difference to *employment* whether wages or other money incomes are high or low, or how they are distributed, what is the level of interest rates or prices, whether industry is technically efficient or clumsy, what the supply of capital may be, whether people are rich or poor, densely or sparsely settled, whether they possess rich natural resources or are poorly endowed; all these are irrelevant to the fundamental determinant of full employment—the steady intake of receipts by enterprisers sufficient to cover their costs, including those for their own services. Most of the things above cited are a cause, or reflection, of per capita productivity at *any* level of employment but they have no necessary bearing on the level of employment actually attained.<sup>25</sup>

#### SAVING AND HOARDING

Under no conditions, then, is there any *inevitable* lack of purchasing power for all the goods that can be turned out. Saving, as such, causes no necessary difficulty. Thrift is an economic virtue of which it is at least unlikely that we shall have too much. Yet it is often maintained that, in the more advanced capitalistic states, there is an excessive amount of it. The cry has been recurrent, with every depression, for decades. Real capital has, however, been rather steadily accumulated, during all this period, without any permanent sense of oppression. The fact is that we cannot hold

<sup>25</sup> Many of the factors cited may, under given conditions, affect the marginal propensity to consume, and this, of course, may be an important factor in determining the proximate determinant. The proper remedy is then to change the conditions along the lines suggested in the ensuing chapter.

capital to be excessive until the rate of interest on long-time loans falls below zero and stays there. This has never yet occurred, if indeed it is possible, and there is no convincing evidence that there is even any secular trend in that direction.<sup>26</sup> We can conclude, at least provisionally, that the desirability of thrift, so far as it results in the accumulation of capital, remains unimpaired.<sup>27</sup> Individual thrift can, however, result in social benefit only so far as it issues in an increase in the sum total of durable goods, which is the only form in which social saving can take place.

Monetary hoarding at any time may, under existing institutions, be justified from the business point of view, but, unlike thrift, it has no social justification since it cannot result in social saving. The sole *raison d'être* of economic activity is consumers' goods and the only sensible social procedure is that which may be described as turning money into such goods, directly or indirectly—that is, as promoting the production of consumers' goods by appropriate outlays of money. When there is a widespread attempt to reverse this procedure, to turn goods into money and keep the money, men have forgotten the only social purpose of economic activity. They are afflicted with the disease of Midas and, so far from making goods, become afraid of production.<sup>28</sup> Any proposal to organize the unemployed to provide for their own needs is then violently resented by enterprisers as “unfair” competition, on the apparent assumption that the economic system is a mechanism for furnishing pecuniary profits to enterprisers rather than that pecuniary profit is, as yet, a far from perfect mechanism for providing the community with goods. If prosperity is ever to return after depression, it is obvious that “competition,” in the sense that there are more goods on the market, must increase. The fighting off of this type of competition is therefore nothing more nor less than a decision for the postponement of recovery.

<sup>26</sup> cf. Gustav Cassel, *The Nature and Necessity of Interest* (Macmillan and Company, Ltd., London, 1903), *passim*.

<sup>27</sup> It is an illusion to suppose that, as is so widely believed, there is any *inherent* association of capitalism with commercial, or other, imperialism as a means of furnishing an otherwise failing “outlet” for capital.

<sup>28</sup> The desire for liquidity is a chief source of the businessman's tendency to restrict output and, as a means of doing so, to get some kind of monopoly power. It is also the reason for the prevailing dominance of business by financial, rather than economic, considerations.

The recurrent passion for liquidity is both a cause and an effect of a depression in the general level of profits. When the preference for liquidity rises, profits disappear and, when profits disappear, the attractiveness of liquidity, to enterprisers at least, is greatly enhanced. Either, therefore, corroborates the other.

It can scarcely be doubted that the bulk of hoarding is done by enterprisers themselves, either as individuals or in a corporate capacity. The great majority of people cannot or will not hoard. This follows, *a fortiori*, from the fact that the lower income classes, as a group, cannot or will not save. Their income is so small relative to even urgent wants that they will disburse that income, whatever it may be, at a practically unchanged rate in good times and bad. It is the comparatively few wealthy individuals, for the most part enterprisers though perhaps only as investors in equities, who can, and at times do, practice hoarding on a large scale. Together with business corporations, acting indirectly through their directors for the enterpriser owners, they do the bulk of the hoarding. Enterprisers themselves are thus mainly responsible for those absorptions from the circuit flow of money which result in business losses. They are themselves, therefore, the architects of their own ruin, but they involve practically the whole of society in their fate. If disaster is to be avoided, society must be guarded against the action which enterprisers and business concerns, as individual units, are impelled to take. Liquidation appeals to enterprisers, in a period of depression, as the sole means of saving their own concerns in a situation which is, in fact, the direct result of the generalization of their conduct. Such liquidation must be stopped before depression can lift.<sup>20</sup>

It is desirable, however, to check declines in, as well as enhancements of, the preference for liquidity. When liquidity-preference declines, a drawing on hoards causes money to flow to producers at a faster rate than it is currently accruing to recipients of income in the productive process. Profits then rise so sharply as to provide investors with funds in excess of those which more or less well established investment habits will disburse. Even with a relatively

<sup>20</sup> The effect of the action of enterprisers in the commercial banking business is especially devastating since this, through the calling of loans and the consequent reduction of bank deposits, not only checks the smooth flow of the monetary stream but actually dries it up.

weak preference for liquidity, investment will not be adequate long to absorb both the formerly accumulated funds and the current excess of income over what is expended for consumption. This will presently check the return flow of income to producers, profits will fall, the previous relaxation of the preference for liquidity will be reversed, the incipient decline in profits will be exaggerated, and unemployment will develop.<sup>30</sup>

#### REVERSAL OF PREFERENCE FOR LIQUIDITY

It is possible, of course, to check or reverse any increase in the preference for liquidity through the injection of an unlimited volume of new issues of money into the income stream. If this process of inflation goes far enough, liquidity will become a horror rather than a desideratum. Money profits will rise, and "business" will boom, but only so long as the pace of inflation is maintained or, perhaps, accelerated. Sooner or later a choice has to be made between stopping the process, and thus inducing depression, or proceeding to a state of complete economic delirium.

Moderate increases in the issue of money are not a very effective remedy for a deflation of profits because the course of inflation and deflation are not, in all respects, the converse of one another. There is no *inherent* check to a deflationary situation. Falling profits and prices, the resultant of a hoarding complex, increase the preference for liquidity of which they are the expression. The spiral of contraction may therefore proceed indefinitely. There is no early limit to the possible withholding of expenditure. Inflation, on the other hand, will ordinarily burn itself out unless the fires are persistently fed with new and larger issues of money. Previously hoarded money can ordinarily be disbursed but once without forming part of a payment in a new productive process. Inflation is, therefore, unlikely to be continuous without persistent stoking. In the absence of new monetary issues prices can rise indefinitely only as enterprisers pay out in the productive process ever larger sums of money per unit of physical output. This will seldom, if at all, be done so long as unused labor and other resources, typical of a de-

<sup>30</sup> The community may, however, develop new channels of investment rather rapidly and thus postpone the slump. A good case could be made for the contention that prosperity in the United States has, in recent decades, been conditioned by such investment as, in retrospect, at least, could only be regarded as reckless.

pression, are present in every branch of industry. Entrepreneurial receipts, as a whole, will not then run greatly, or for long, above more or less fixed contractual payments in the process of production, and the original "priming" will have no multiplied effect.

The proximate cause of shifts in the preference for liquidity is always fear, which is the great corroder of economic as of other power. The preference for liquidity increases when there is a fear of loss in holding, or acquiring, assets in the form of goods rather than in the form of money, and diminishes when there is a fear of holding assets in the form of money rather than in the form of goods. In the one case—deflation—the social loss of power is immediate; in the other case—inflation—power is at first released but, if the inflation is continued, it is presently perverted and then finally lost as economic virtues are undermined.

#### THE NORM OF LIQUIDITY

In a situation in which there was no fear of either deflation or inflation there would be a desire on the part of individuals to hold in monetary form a substantially fixed proportion of income. This desire would arise mainly out of the usefulness of money as a medium of exchange or as the most convenient reserve against contingencies other than a shift in the relative desirability of money and goods. Such a desire may be thought of as the liquidity norm. Any deviation from this norm, in either direction, sets in motion forces which, if not compensated, will have devastating effects.

Stable full employment<sup>31</sup> depends upon an unchangingly fair general prospect for profits and this, in turn, depends upon the maintenance of a norm of liquidity desire or, if a temporary shift in the preference for liquidity occurs, upon a compensation of the otherwise ensuing fluctuations in the flow of incomes to enterprisers as a whole.

In the maintenance of a substantial constancy in the desire for liquidity the essential requirement is the removal of the fear of holding either goods or money. Where this cannot be completely accomplished, a nullification of the effects of shifts in liquidity,

<sup>31</sup> The term "full employment" has, no doubt, a somewhat elastic connotation but it can be interpreted with some looseness without great injury to the thesis of the present book. There is not much doubt about its opposite, long-continued involuntary unemployment.

through storage and release of commodities against new issues and retirement of money, is the appropriate solution of the difficulty.

In the field of finance we have slowly and painfully learned that society, in its collective capacity, must assuage the fears of individuals and provide liquidity when there is a general passion for it. Central banks, therefore, in times of financial crisis, take over certain illiquid assets to any requisite amount and furnish liquid assets in exchange for them. The very knowledge that this will be done usually prevents fears from developing and, in any case, greatly reduces them. When the fear has passed, the central bank reverses the process and all is as it was before the fear developed. Financial crises have thus been either eliminated or made of merely passing import. But we have made no application of the principle in the economic, as contrasted with the financial, sphere. The result is that, while financial panics are now readily overcome, economic depressions linger on unconscionably. We have yet to learn to make money the servant rather than the master of economic life. The first, perhaps the only, step necessary to this end is to offer unlimited liquidity to producers of goods in times of economic stress just as we now offer unlimited liquidity to certain holders of financial instruments in times of financial stress. If producers of goods can have liquidity at will they will be under no temptation to provide for a contingency which would then have been eliminated but which, under existing conditions, is provoked by the very attempt to make provision against it. When the tendency to hoard money is largely, if not completely, removed, there will, as cause and consequence, be a steady prospect of profits to business as a whole, the stimulus to enterprise will thus be persistent, and the principal source of unemployment will be removed. Provided a recurring enhancement of the preference for liquidity can be nullified there is reason to believe that full employment, at once an outcome and a condition of a fair prospect of a stable flow of profits in general, will be persistently attained.

It is, at any rate, certain that we cannot have a satisfactory economic system so long as the fear of production recurrently, and to some extent persistently, overrides both the hope in production and the fear of what ought to be the consequences of a refusal to produce. Institutional arrangements under which the strength of the hope of good results from production, or the strength of the



fear of evil consequences in refraining from it, does not surpass the strength of the hope of a more satisfactory issue from a widespread restriction of production, or the strength of the fear of the evil consequences of producing, are fit only for Cloud-cuckoo land. We have, in the United States, achieved the zenith of Cloud-cuckoodom in the policy of actually paying people not to produce.<sup>32</sup> Since there are no limits on what we might fail to produce there is no logical limit on such payments short of taking most of such output as is, despite any discouragement, produced, and turning it over to the people who, under instigation, have graciously consented to remain idle.

With whatever vehemence we may reject the present organization of industry in Germany it has at least escaped from this Ali-cian type of economics. The businessman in Germany cannot now afford to indulge the luxury of contemplating his state of confidence and of deciding whether or not it is sufficiently great to lead him in the ways of production. Whatever his fear of production his fear of refraining from it is, for excellent reasons, immensely greater.

Fear, of course, is a much less desirable motivation than hope and it is, moreover, perfectly possible to establish conditions under which the hope of a favorable outcome of production will be general. The fear of refraining from it need then be nothing more than a fear of the loss of a proportionate share in the social output. We can, in a word, set up free institutions under which there will be enthusiasm for enterprise, and the paralyzing fear of production will be completely, automatically, and forever, dispelled. Unless this is done our economic institutions can never have a rational basis and our economy will always be at the mercy of fear and the fear of fear.

<sup>32</sup> This has persistently been done, on a large scale, by the AAA.

## CHAPTER V

### MONEY

THE preceding chapter has indicated that the principal source of fluctuations in total income, and therefore in profits and employment, is the misbehavior of our monetary institutions. Money expenditure is an essential preliminary to all money income and any uncompensated check on expenditure is certain to reduce total money income, affect profits adversely, and provoke unemployment. Such a check on expenditure is always the result of a rise in the preference for liquidity, which is the proximate cause of all depressions. Whatever the cause of an original increase in the preference for liquidity the preference is self-inflammatory. The more liquidity is sought, and even attained, the more desirable it will seem since it will provoke business losses and falling prices. The one makes liquidity necessary, the other makes it profitable.

#### ISOLATED VS. CONCERTED ACTION

It has been already suggested that the only way for an enterpriser to cut losses in such a situation is to cut outlays—that is, discharge workers—since no single concern or any single branch of industry can then operate at capacity without grave risk of disaster to itself.<sup>1</sup> Its outlays would be spent by recipients only in small part, if at all, for the concern's own output. It would therefore be left with unsold stocks of goods on its hands and, with steadily continuing costs, would be driven to bankruptcy. But if all concerns should simultaneously resume full operation the outlays of each would accrue to the others and a substantial and sustained activity would be substituted for deadlock. The self-inflammatory phase of the preference for liquidity would then not only be checked but reversed, and even the originating cause, which is largely traceable to fear of just such a cumulative depression as would then have been overcome, might well disappear. Some such idea is behind governmental "pump-priming" expenditures. But

<sup>1</sup> This is perhaps true only where firms are of such a size as to make their action a significant factor in the whole market for their product. But this is now the typical situation.

"pump-priming" has several defects any one of which may prove fatal.

#### DEFECTS IN PUMP-PRIMING

In the first place, pump-priming relies on a chain of communicated stimuli. The communication takes time and during that time "leaks" may develop which will render the priming null and void. That is to say, the money spent under the program may come into the hands of those who will hold it. The original impulse then fades out without accomplishing its larger purpose. This is the more probable in the degree that enterprisers are vaguely fearful of the fiscal deficit which is the usual, and perhaps essential, accompaniment of pump-priming expenditures.

In the second place, the stimulus is, by definition, ephemeral, and this leads to fears of what may happen when it is withdrawn. Such fears will inhibit any long-term commitments. The producers' goods industries—always the most severely hit in depression—therefore receive no orders except such as may be the direct consequence of the original outlays. The result may be a mercurial condition even more discouraging to enthusiasm for enterprise than is persistent lassitude. No encouragement toward investment will be felt even when activity in consumers' goods industries is, temporarily, great. The failure of investment will dampen and eventually extinguish the momentary flare-up in the consumers' goods industries. Even persistence in pump-priming is therefore of little avail without *assurance* of its indefinite continuation.

Indefinite continuation, however, with or without assurance thereof, encounters a third difficulty in that the priming expenditures are outlays for which the disbursing government gets no *quid pro quo* whatever (as e.g. in expenditures for straight relief) or gets a *quid pro quo* in a nonsalable form (roads, bridges, public buildings, parks, and the like). In the former case the expenditures, per se, are unproductive in any sense and in the latter they are unproductive in the business sense of offering no prospect of a pecuniary return, either of principal or interest, to offset the pecuniary outlays. So far as they are not financed by taxation (and taxation in volume commensurate with the spending would merely exaggerate that desire for liquidity which the spending is designed to overcome) this means a steady progression in government debt.

The significance of such an increase of debt will be discussed in a later chapter; it is enough to say at this point that it does not add to the confidence of those who are in strategic positions to determine the scale of entrepreneurial outlays.

#### A FEDERAL RECOVERY CORPORATION

In an effort to meet these defects in pump-priming expenditures the present writer some years ago proposed that a government corporation be set up, in times of depression, to provide indefinite liquidity for productive organizations without cost to the government. Paralleling the action of central banks in a financial crisis (which turn illiquid into liquid assets and, when the passion for liquidity has declined, reverse the process), a government corporation in an economic crisis could take over vendible goods, paying for them with new issues of money on loan from the Treasury or with funds borrowed from the banks, and later turn the goods back to the enterprisers.

The only thing that can confidently be counted on to reduce the desire for liquidity and stimulate industrial activity is orders in hand or in immediate prospect. When, therefore, a general depression occurs, a Federal Recovery Corporation (FRC) might place orders with all responsible manufacturers of standard, storable, finished goods (including capital goods where such are standardized) in the proportions prevailing in output in the pre-depression period. The details of this proposal can perhaps be best expounded by paraphrasing a former presentation of it.<sup>2</sup>

The FRC would use a repurchase contract along the following general lines:

1. The manufacturer agrees to quote to the FRC a price on his product or products no more than sufficient to cover his actual outlays for labor, raw materials, user-cost of equipment, and power;
2. The FRC agrees to pay in advance for these products (on which it will impose a lien) with new money furnished by the

<sup>2</sup> cf. "An Economic Answer to the Problem of Unemployment," a paper prepared by the present writer for a meeting of the Economic Advisory Council of the National Industrial Conference Board, New York, June 13, 1939. This was a review of proposals made in 1933 in my article in the Spring Number of the *Economic Forum* on "The Creation of Employment." This article developed out of prior, rather different, proposals in my book *The Abolition of Unemployment* (Princeton University Press, Princeton, N.J., 1932), and this book, in turn, incorporated proposals privately circulated in 1931.

Treasury or borrowed from banks. The goods are to be stored under seal, on the manufacturer's premises or elsewhere, and insured with, and for the benefit of, the FRC. Title remains with the manufacturer;

3. The manufacturer agrees to give to the FRC a demand note to the amount of the FRC's advance. This note will be paid off *pari passu* with the release of the lien on the goods as they are repurchased by the manufacturer from the FRC;

4. The FRC agrees not to call for payment of the note except on release of the lien at the request of the manufacturer;

5. The manufacturer is entitled to sell the goods to any buyer at any price he can get;

6. The manufacturer agrees not to fill any orders from private customers for similar goods, without the consent of the FRC, except from the stocks under lien and for as long as such stocks remain on hand;

7. The FRC agrees to give new and larger orders in proportion to the speed with which the original goods are taken off, but no new orders will issue for goods which accumulate, in proportion to other goods, in amounts markedly out of correspondence with consumption in prior periods of full employment as modified by the probable future development of the several industries concerned.

#### ARGUMENT FOR THE FRC

After production had thus been directed according to developing demand, such goods as were not sold within a fairly lengthy period might be taken over by the FRC. The FRC would agree not to sell these goods in such manner as to depress markets but, so far as possible, it would be free to distribute some of them as relief to unemployables or use them in public works projects. In exercising the option to take over such goods, the FRC would, of course, cancel the obligation of the manufacturer relative to these goods.

To guard against "chiseling" by such manufacturers as would, without cooperating, attempt to get the benefits of the cooperative action, a small processing tax might be levied on all goods which did not pass through the FRC's hands. There is no reason why all eligible goods should not do so. This would give to producers a much more accurate notion of total demand and supply, for the various classes of goods, than they now have.

The purchasing power laid out in the production of the goods ordered by the FRC must, in a very large measure at least, return to it within a short period as the expanded purchasing power in the hands of consumers goes first to retailers,<sup>3</sup> retailers order from wholesalers, wholesalers from the factories, and the factories take the stock off the FRC's hands. The purchasing power so received, and the original loan, is then retired through transfer of the money to the Treasury, for destruction, or to the banks. Payments made in the course of production of producers' goods will be largely directed by the recipients to consumers' goods, along with payments to workers in the consumers' goods industries themselves. These payments will operate to increase the sale, and raise the prices, of consumers' commodities to a point sufficient to make it worth while for manufacturers of consumers' goods to replace, renew, and expand their equipment. This will set up a demand for producers' goods, and will take off those that will have been produced. The "acceleration principle," leading to a boom and subsequent depression, would, however, have little chance to operate, since sales of standard capital goods, or the raw materials thereof, will be made out of existing stocks and there will therefore be no such strong tendency as at present to overextend equipment, during boom times, in the capital goods industries.

Since his plant will, in any case, be operating, and he will be able, at no cost to himself, to accumulate what is, in effect, an inventory of finished goods, the manufacturer will be subject to no pressure to sell to the private market at prices which will not cover depreciation of equipment as well as immediate outlays.

The FRC need not be greatly concerned with the relative efficiencies of the manufacturers to whom it gives the original orders, or even with the prices it pays. Going factories can presumably sell their standard output to an expanded demand at prices in excess of their prime costs and will reap profits or losses in their *total* costs proportionate to their efficiency. The more efficient can keep prices relatively low without loss. They will therefore sell their goods

<sup>3</sup> Somewhat more than 60 per cent of all income is spent in retail stores. cf. United States Department of Commerce, *Statistical Abstract* (Washington, 1940). The proportion of national income produced in factories is, normally, a good deal less than half of this. cf. Maurice Leven, *The Income Structure of the United States* (Brookings Institution, Washington, 1938), p. 132.

more readily and will obtain the bulk of the new private orders. The less efficient will be forced to the wall as of yore. Some irresponsible producers might deliver to the government goods which they never intended to take back, but this sort of thing would not bulk large at any time and could speedily be eliminated.

The question will be asked how the situation differs from governmental purchases of wheat, cotton, and other commodities, which have not been markedly successful. The answer is that we have bought the *relatively* overproduced wheat and cotton at prices, above the equilibrium level, which stimulate rather than retard the output of these relatively oversupplied commodities. We have thus been making the situation progressively worse. We have maintained the production of the relatively oversupplied commodities and suffered that of the relatively undersupplied to fall off. The result is a relative plethora, which necessitates artificial methods of control, in the production of the already relatively overproduced products.

If, however, industrial production, all round, were going at full speed, with increased purchasing power in the hands of workers, there would be no need for any such control. There is at least enough virtue left in the contention of the classical economists, that *general* overproduction is impossible, to dispose summarily of the notion that the proposal here made is on all fours with the governmental acquisition of *relatively* overproduced products.

It is well to consider what is the worst that could happen from the initiation of the project. There would be some slowly-moving and some unsold goods. The stocks of goods which were merely slow to move would be worked off gradually, since no new orders for such goods would issue from the FRC and it would be clearly useless for the manufacturer to produce on his own account when he could not sell what he already had in stock. Goods which could not be sold, even if they were eventually offered to prospective buyers at prices which just covered labor and materials, would revert to the FRC (unless the FRC should prefer to reduce its claim against the manufacturer and let him have the goods at whatever price they would command). The use of some of them in relief to unemployables would minimize the real loss. Expenditures which would otherwise be necessary in direct relief or on dubious public works would thus be saved. Any net losses must eventually be cov-

ered by taxation, but both the real and the monetary tax base would have been greatly broadened, public revenues would automatically increase, and net public expenditures would be enormously reduced. If some rise in prices were to occur, even goods which had been almost stagnant could be cleared at cost price, and the release of goods from the FRC's stocks would be a perfect hedge against inflation.

Even if none of the increased production were sold we should be no worse off; in fact, we should be much better off than without it.<sup>4</sup> People would be receiving money incomes and could obviously not be in very exigent circumstances if they failed to spend them. The assumption that nothing would be sold, however, is absurd. Production would be automatically directed toward developing demand and orders could be so given that any stocks more or less permanently accumulated would be such as would be useful for governmental purposes. There would be no interference with ordinary channels of trade; the efficient producer or seller, carrying on his business precisely as he now does, could make profits while the inefficient would be eliminated; ancillary and service industries would flourish along with the primary industries; curtailed working weeks and other methods of restricting production would be unnecessary; and the adolescent population would be drawn into the lines of activity where opportunity beckoned.

With a slight shift in the sequence of events we should, in fact, be doing under this project precisely what would be done if a real revival were somehow, and sometime, to begin under an "automatic" restoration of confidence. Instead of waiting for an extremely coy confidence to put in an appearance in some indefinite future, we should, by creating a market, establish it at a stroke. Except for the proposed small processing tax, which might not be

<sup>4</sup> It is perhaps in point here to cite a story of the campaign in which Upton Sinclair, in the depths of the depression of the '30's, sought the governorship of California on a program to abolish poverty in that fertile state. Sinclair was far from being as visionary or as foolish as those who sought to smear him alleged him to be. One of his critics, George Creel, charged Sinclair with having the mind of a pigeon. Sinclair, in his reply, said that he was no ornithologist and did not know just what kind of mind a pigeon had. He did know, however, that he would rather have the mind of a pigeon than that of George Creel since he was quite certain that no healthy pigeon had ever starved to death when, all around it, the ground was strewn with corn. Yet this was precisely the situation, in human affairs, for which Creel was making an apology.



necessary, there is no trace of regimentation in the proposal since no one is impelled to do anything against his will.

#### COMMODITY RESERVE MONEY

In the same number of the *Economic Forum* in which these proposals were made there appeared an article on "Stabilized Reflation" by Mr. Benjamin Graham. Though he and I were then complete strangers to one another there was a remarkable coincidence of ideas in the two articles. Mr. Graham has elaborated his proposals in his book *Storage and Stability*<sup>5</sup> and, with the exception of comprehensiveness, I have come to believe that they are distinctly superior to my own. Their preeminent virtue lies in the fact that they are designed to establish a unique correlation between goods and money and to provide not only an unlimited demand for a wide variety of commodities, of the same character as the unlimited demand for gold under the gold standard, but also for such stability in the price level as we have never yet been able to attain. The necessity for a stable price level, as a prerequisite of that stability in the general rate of profits on which a sustained productivity depends and as a condition of rational action by enterprisers, is obvious.

The essence of Mr. Graham's proposals is contained in the following summary of his writings on the subject.<sup>6</sup>

**THE GENERAL PLAN:** To provide a monetary base of essential, storable, raw commodities in common use, against which currency would be issued, by which it would be secured, and in which it would be redeemable, thus according exactly the same monetary treatment to a composite group of specified commodities as was formerly accorded to the single commodity, gold.

**DETAILS:** "Commodity units" would be set up by law, as monetary units, and would be defined in precisely the same manner as the dollar was formerly defined as a fixed weight of gold. These units would consist of a composite of basic, storable, raw commodities. The relative amounts of the various commodities to be

<sup>5</sup> McGraw-Hill Book Company, New York, 1937.

<sup>6</sup> This summary is a slightly modified adaptation of a publication of the Committee for Economic Stability to which, as a member of the Committee, the present writer contributed. Such (minor) changes as have been made were not submitted to the Committee, which might, or might not, give its endorsement to them.

included in the composite would be determined by their relative importance in commerce. The size of a commodity unit would be such as to make it convenient for purposes of deposit and redemption. The fraction of a commodity unit (e.g. 1/10,000) that would be equivalent to a dollar would be fixed at the time of the enactment of the plan by Congress and would, presumably, be determined by the average of market prices, of the group of commodities composing the unit, over a preceding period of years. These are matters of not very difficult statistical calculation.

The Treasury would issue legal-tender currency against the deposit of warehouse receipts (such as are currently dealt in on commodity exchanges) constituting one or more complete commodity units, or, per contra, the Treasury would surrender such warehouse receipts in exchange for an equivalent amount of currency. Just as formerly anyone could deposit or withdraw gold in exchange for currency, anyone could now make deposits or withdrawals of commodity units for currency, at any time, in exchange the one for the other.

Thus the dollar would, in effect, be a warehouse certificate having all the desirable characteristics of a gold certificate and of gold-secured money—solid backing, redeemability, limitation of issue—plus certain highly important qualities now lacking in our money.

There would be suitable provisions for: (a) periodic but infrequent changes in the composition of the commodity units in accordance with shifts in the relative commercial importance of the various commodities comprising the unit; (b) defraying the expense of commodity storage; (c) substitution, under stated conditions, of "futures" contracts for the actual warehouse receipts; and (d) the possible inclusion of substantial components of gold and silver, in the commodity units, and the redemption of the certificates in gold or silver at the option of the holder.

OPERATION: If, from whatever cause, the aggregate market price of the group of commodities composing the commodity units should begin to fall below their total minting (reserve) value, anyone could buy the commodities on the exchanges, deliver to the Treasury a group of warehouse receipts covering the appropriate amount of each of the commodities, and take out their equivalent in currency. This would have the effect of supporting the market

price of the reserve commodities taken as a group and, since it would increase the supply of money, would tend to support the general level of prices.

If, on the other hand, the aggregate market price of the group of commodities composing the commodity units should, for any reason, begin to rise above their total redemption value, anyone could withdraw commodity units from the Treasury at the fixed currency value and sell the commodities on the market. The currency thus redeemed would be retired and destroyed. This would have the effect of lowering the prices of the specific commodities in the unit and, since it would reduce the supply of money, would tend to check any rise in the general price level.

The limits of fluctuation of the aggregate market price of the group of commodities in the unit would therefore be narrow, depending upon what (if any) "seigniorage" charge was adopted, plus the commission, and other costs, of withdrawing and selling units or of assembling them for deposit in the reserve—all together probably not exceeding one or two per cent.

RESULTS: The results would be:

1. Stabilization within narrow limits of the average price of the group of commodities composing the commodity unit.

2. Provision of a "sound" (that is, a solidly backed) dollar of substantially constant purchasing power—thus preventing the far-reaching and serious political and social consequences of monetary inflation and deflation.

3. Elimination of the paradox of "poverty in the midst of plenty" by preventing destruction of the purchasing power of primary producers, and their employees, such as now occurs in depressions.

4. Promotion of equity as between debtors and creditors, employers and employees, and the parties to all contracts involving the two elements of time and money.

5. Assistance in stabilizing business and economic conditions generally.

6. Provision of an alternative superior to expenditures on public works and other such inept means of providing employment in times of depression.

7. Creation of a reserve of primary commodities which might be of vital importance in some great emergency such as drouth, pestilence, or war.

8. Advancement in the scale of living, through production at maximum levels, with maximum employment, along with facilitation of adjustments necessitated by technological progress.

9. Checking of inflationary booms by the withdrawal from the reserve of important raw materials and the consequent redemption and cancellation of the equivalent currency.

10. Improvement of the facilities for foreign trade and finance by providing a means of payment, in tangible goods, of sums due on foreign debts, or for our exports, without any depression of our markets. There could be no competitive depreciation of exchange since the dollar value of foreign currencies would be automatically correlated with the foreign currency price of the composite of commodities in the unit.

#### ARGUMENT FOR COMMODITY RESERVE MONEY

The plan does not involve the fixing of the prices of individual commodities, which would be left entirely free to fluctuate with changing demand and supply. What would be fixed, directly and within narrow limits, is the *aggregate* price of the commodities in the unit, but the relationship among the prices of the individual commodities would be as free to vary as it ever has been. Indirectly, the *level* of the prices of *all* commodities would be substantially stabilized, since the play of competition would prevent any large or persistent discrepancy between the different classes of commodities (those within and those outside the unit).

The procedure is automatic, impersonal, non-political, and self-controlling, involving no necessary use of an index number,<sup>7</sup> no curtailment of production or regimentation of any sort, no necessary modification of banking or market procedures, no vesting of discretionary powers in anyone for managing the currency or regulating prices or production or consumption.

The gold certificates formerly in general circulation in the United States, and now in the hands of the Federal Reserve Banks, are warehouse receipts evidencing the deposit of a fixed weight of gold, of a specified fineness, in the vaults of the monetary authorities. Mr. Graham's proposal is simply to substitute a wide variety

<sup>7</sup> An index number is not necessary, though probably desirable, even for the initiation of the process, since the going price of the composite of commodities in the unit could be taken as of the date of inception or of any other specified date.

of commodities for the single commodity gold. Just as formerly there was, by law established, an unlimited two-way market for gold at a fixed price so there would here be an unlimited two-way market at a fixed price for the designated composite of commodities.

Gold mining is one of the very few industries which always enjoys a boom in periods of general depression, but the scale of the industry is inadequate to provide sufficient employment to reverse, or even substantially retard, the general downward trend.<sup>8</sup> The sole reason for the exceptional behavior of the gold mining industry is the character of its market. If a similar market were given to a much larger sector of industry there can be little doubt that severe business depressions could, at most, be of very short duration.

The requirement that the commodities in the unit be delivered to the reserve as a group, in fixed relative quantities, would, of course, operate equally on all the commodities in the unit. There would be no special demand or market for surpluses of any one commodity. Commodities in the unit, *relatively* oversupplied in the general markets, would therefore fall in price but, since the aggregate price of the composite is fixed, other commodities in the unit, *ipso facto* relatively undersupplied, would share in an automatic price rise. This is precisely the mechanism required to effect an appropriate adjustment of the relative supply of the various commodities to the demand for them and, as there would always be better opportunities open, as an alternative, to those who were suffering from a fall in the prices of the goods they were producing, there would be no tendency toward a continuation of maladjustments.

#### AUTOMATIC COMPENSATION OF SHIFTS IN THE PREFERENCE FOR LIQUIDITY

No matter what the public preference for liquidity might at any time prove to be, there would then be no general restraint on industry. The retardation in the flow of money arising from the en-

<sup>8</sup> Where gold mining is a dominant industry in a small country, as in South Africa, this is not true and South Africa, in consequence, has enjoyed remarkable stability in its economic life. When conditions favored gold mining the expansion in that industry has taken up the slack in others but, when they did not, the conditions for other industries were, *ipso facto*, good.

hancement of the preference for liquidity would be precisely compensated by the new money issued in exchange for the goods delivered to the reserve. The composition of output would be temporarily altered but there would always be a market expanding *pari passu* with total supply. Since the principal causes of a passion for liquidity—the lack of markets and the fear of falling prices—would have been removed, the probability is great that the effects of any disturbing shift in the preference for liquidity would quickly disappear and that, after some experience with the results of the plan had been obtained, the very memory of them would sink into oblivion. Liquidity, under stable prices, means that the holders of money get no return on their resources and, though preferable to losses, has nothing on the positive side to commend it to enterprisers.

So soon as the desire for liquidity showed any tendency to rise and the ordinary market for goods, in consequence, shrivelled, resort would be had to the alternative market always available for the designated staples. The issuance of money against these goods, and the withdrawal of the goods, must before long assuage the thirst for liquid assets.<sup>9</sup> The money paid out in the process of production of the goods gathered into the warehouses could be spent, if spent at all, only for other goods and, together with the expenditures of recipients of payments in the process of manufacture of these other goods, would raise the prices of such goods above costs of production.<sup>10</sup> A large part of those costs would be for raw materials included in the commodity unit. The *average* cost of these raw materials could not rise since they would always be obtainable from the reserve at the designated price for the aggregate. The enlarged spread between the new prices of finished goods and the prices of raw materials would lead to an expansion of the output of the former, a withdrawal of the raw materials from the reserve to effect this expansion, and payment therefor of money into the

<sup>9</sup> General liquidity can be increased only by increasing the ratio of the volume of money to the volume of goods coming on to *private* markets.

<sup>10</sup> This could fail to happen only if the expansion of purchasing power consequent upon the delivery of goods to the reserve were more than compensated by a coincident contraction in other industries. Since there is no limit on the expansibility of demand for reserve commodities this could not be a permanent difficulty but it is quite possible that it might produce a temporary depression. The more comprehensive is the coverage of goods in the unit the less is this likely to occur.

Treasury. The retirement of this money as it came in, and its subtraction from the flow of income, would presently bring the prices of finished goods into the appropriate correspondence with those of raw materials, both correlating with costs of production.<sup>11</sup>

The unlimited market for the materials in the commodity unit permits indefinite expansion of employment in them and, if employment should for the time being fall in finished goods' industries, a transfer of labor from such industries to the industries producing for the reserve would be set in motion. In many cases this would mean nothing more than a shift of emphasis within a single producing concern and, as has been shown above, would be self-limiting and self-reversing.

In prosperous countries a large proportion of the population is engaged in what Professor Colin Clark calls tertiary production, that is, commerce, transport, and the provision of services, as against (1) the primary production of agriculture, forestry, and fishing, and (2) the secondary production of manufacture and construction.<sup>12</sup> If, however, money is paid out for production in primary and secondary industries (with some of the product temporarily entering the reserve), and a large part of income is spent on tertiary production, the transfer of workers to meet the increased demand for tertiary products will presently reduce the relative supply of primary and secondary production to the appropriate proportion to the whole. If monetary demand is persistently sustained any structural maladjustments that may appear will be subject to steady elimination.

With full employment, and mobility of labor, the wages of a given grade of labor in the various industries, whether producing commodities within or without the unit, must be substantially equal. The total relative cost of production of raw materials and finished goods, as wholes, would therefore vary in the long run only in proportion to the changing *relative* effectiveness of produc-

<sup>11</sup> The procedure is precisely that employed in the most successful cases of gold exchange standards where it has been proved that it will keep one currency stable in value against another which is, itself, not stable. If a fixed value relationship can be maintained on an unstable base it is, *a fortiori*, feasible when the base is fixed.

<sup>12</sup> cf. *The Conditions of Economic Progress* (Macmillan and Company, Ltd., London, 1940), *passim*.

tion in the two sectors of industry.<sup>13</sup> Such changes would be reflected in a modest rise or fall in the prices of finished goods (according as the effectiveness in these industries fell or rose relative to that in the industries producing the reserve commodities), but the movements would be slow, predictable, in proportion to changes in costs per unit of output, and therefore of negligible importance in their effect on profits or the enthusiasm for enterprise. They would, moreover, have distinct advantages in a prompt generalization of the incidence of changes in productivity.

#### STABILITY IN THE VALUE OF THE MONETARY UNIT<sup>14</sup>

In order to serve in even moderately satisfactory fashion one of its primary functions, that as a unit of account, the value of the unit of money must be predictable. This is absolutely necessary if men are to pursue coherent courses in a pecuniary society or undertake with confidence any activity beyond that which is expected to come to very early fruition. To be predictable it is not essential that the value of the monetary unit be absolutely stable. It is not a matter for much concern whether the predictability arises from an inverse correspondence of prices with advances in general technical efficiency (which in fact proceed at a remarkably even pace) or from an unchanging price level. The issue is one of expediency rather than of essence since, if it were known that the future value of the monetary unit would be correlated with general productivity, any difference of results which might otherwise arise in the use of this as compared with a unit of stable value would be eliminated in advance by such changes in the terms of all executory contracts as foresight might dictate. It makes, therefore, little or no difference, in principle, whether we seek stability

<sup>13</sup> Absolute and general changes in efficiency would have no effect on commodity prices but, on the other hand, would be fully reflected in the return to factors of production, particularly labor.

<sup>14</sup> The remainder of this chapter draws largely on four articles of mine published, in recent years, in the *American Economic Review* under the rubrics, "Partial Reserve Money and the 100 Per Cent Proposal" (vol. xxvi, no. 3, September 1936, pp. 428-440), "Achilles' Heels in Monetary Standards" (vol. xxx, no. 1, March 1940, pp. 16-32), "Primary Functions of Money and their Consummation in Monetary Policy" (vol. xxx, no. 1, Supplement, March 1940, pp. 1-16), and "Transition to a Commodity Reserve Currency" (vol. xxxi, no. 3, September 1941, pp. 520-525). I am indebted to the editors of the *American Economic Review* for permission here to paraphrase, and reproduce, parts of these articles.



by keeping per capita money incomes horizontal, and suffering the general price index to move inversely in correspondence with changes in general productivity, or by keeping the general price index horizontal and suffering per capita money incomes to move directly in a similar correspondence. A combination of the two methods, with the fixing of the price level of storable raw materials, together with a moderate variation in the price of finished goods in correlation with the relative change in productivity in the two sectors of industry, offers any special advantages that either may have. Either of the two procedures, or a combination of them, would give a steady prospect in the general rate of profits. Except under the automatic system here proposed, however, the difficulties of securing a stable price level and, *a fortiori*, a price level varying in strict inverse proportion with general productivity, are probably insuperable in a system of free enterprise.

#### BROADENING OF MONETARY BASE

There is no reason, other than a perhaps superior administrative convenience, for limiting the number of commodities in the commodity unit and, as experience warranted, the number should no doubt be increased until it included all readily storable goods of a non-specialized character. Thus not only iron ore, but pig iron, steel plates, and the like, not only cotton, but certain standard textiles, might be included. There is a wide range of chemicals that would be eligible.<sup>15</sup> The inclusion of these commodities would expand the area of automatic markets and there would, in consequence, be a more quickly effective promotion of full and balanced employment.<sup>16</sup>

#### POSSIBLE EXCESS OF RESERVES

If there is a persistent disposition to hoard money, net, that is to say if money savings should show a persistent tendency to outrun

<sup>15</sup> I am, for instance, informed that the following chemical products, all of a "normal" value of more than \$10,000,000 annually, would be possibilities: alcohols, ammonia, carbon black, caustic soda, cellulose acetate, coal tar distillates, dyestuffs, explosives, ferro-alloys, glycerine, methanol, nitrate of soda, petroleum solvents, resins, soda ash, sulphur, sulphuric acid.

<sup>16</sup> The relative weighting of raw materials and semi-finished goods in the commodity unit should be in proportion to the value, in the base year, of the various raw materials relative to that added by manufacture in the case of semi-finished goods.

investment, even when the prospect of profits in general was stabilized and interest rates had been adjusted thereto, the volume of commodities in the "reserve" would steadily accumulate. This would be no great disaster but, should the reserve ever become unwieldy and unlikely under any circumstances to be exhausted, a leaf might perhaps be taken from the book of our present monetary and banking policies. The reserve could then be permitted to fall somewhat below 100 per cent through the issue of unbacked notes, in payment of current government charges or expenditures on newly initiated public works, until prices rose sufficiently to lead to drafts on the reserve. Those who accumulate money solely as an expression of power could then be satisfied with a constant growth in their monetary claims while those who think of money as a means to the acquisition of consumers' goods would get the goods, in both cases without any frustration through an alteration in the price level.

#### POSSIBLE EXHAUSTION OF RESERVE

The real danger, however, probably lies not in excessive accumulations of goods but in the opposite direction, that of an inadequate reserve, especially if issues of new money be not confined to, or solely regulated by, the proposed commodity warehouse receipts. If there should be indulgence in persistent *arbitrary* additions to the supply of money, under the full employment consequent upon the use of warehouse receipts for part only of the monetary issues, a sustained rise in prices would occur and this would eventually drain off the commodity reserve entirely. With the loss of these reserves there would be no automatic check on inflation. If such an inflation, though substantial, were eventually stopped, a readjustment of the whole cost structure, or a change in the money value of the commodity unit, would be necessary before the reserve market would be a feasible outlet for production. Such an inflation of the supply of money would, of course, be deliberate sabotage of the essentials of commodity reserve money.

#### ONE HUNDRED PER CENT RESERVES

While there is no *compelling* reason for interfering with the present issues of money (including demand deposits), all new issues of money, after the inauguration of warehouse receipt currency, should perhaps, therefore, be restricted to that medium,

with expansion of demand deposits permitted only against a 100 per cent cash reserve.

The case for 100 per cent cash reserves against the demand deposits of commercial banks has been cogently presented by Professor Irving Fisher,<sup>17</sup> and has received wide support from economists. It is all but self-evident that the issue of fiduciary money should be an exclusive prerogative of the sovereign authority. The reasons are:

1. That fiduciary money, unlike real wealth, cannot with social advantage be indefinitely increased in volume.

2. That to entrust the supply of fiduciary money to the workings of free competition would therefore not only result in no social advantage but would, on the contrary, bring chaos.

3. That a full, or partial, monopoly of the issue of fiduciary money is, in consequence, indispensable.

4. That such a monopoly permits of seigniorage profits in the nature of a tax on the community at large.

5. That the power to tax cannot properly be granted as a privilege to any group of private citizens.

These principles have long been recognized with respect to fractional metallic money where the fiduciary element is partial only. But where the money is much more completely fiduciary, as in bank notes or demand deposits subject to check, we have drawn the inevitable inference slowly or not at all.

#### THE MONETARY REVOLUTION

The fact is that, in the course of not more than two centuries, the world has passed through a monetary revolution in which it has almost ceased to use any form of tangible wealth as money in internal circulation and has gone over to the use of debt. It has scarcely been aware of what it was doing. The private debtors, therefore, whose obligations now circulate as money, have, without much ado, been permitted to take more than 90 per cent seigniorage on their issues.<sup>18</sup> It is true that they have ordinarily been

<sup>17</sup> cf. *100% Money* (Adelphi Company, New York, 1935).

<sup>18</sup> This is on the assumption that average reserves are something less than 10 per cent. In recent years required reserves in the United States have been raised above this percentage but, in the presence of large excess reserves, this has had no effect in reducing the existing volume of bank credit.

held to a redemption of their promises, but governments have likewise usually redeemed any fiduciary fractional currency presented to them for that purpose. In neither case have the seigniorage profits been much curtailed, since it is the reservoir of fiduciary currency always in circulation which is significant rather than the influx or efflux of individual atoms. The pursuit of profit by the banks has gradually brought it about that the great bulk of our money, instead of being a commodity asset, is an impalpable private liability with will-o'-the-wisp characteristics and of very dubious virtue.

#### PRIVATE ISSUES OF FIDUCIARY MONEY

Appreciation of the fact that it is wrong to put the provision of the supply of fiduciary circulating medium in the hands of private individuals, for exploitation to their own profit, is now much less keen than it was when the practice was in its incipient stage. No one will suspect John Adams of demagoguery; but he was quick to denounce any issue of private bank notes as a fraud upon the public. "Every bank of discount . . .," said Adams, "is downright corruption. It is taxing the public for the benefit and profit of individuals; it is worse than . . . continental currency, or any other paper money."<sup>19</sup> It was clear to our second President, who had had abundant experience with irresponsible public as well as private issues of money, that if fiduciary currency in any form was to be issued it should be issued by the government so that the public should gain with the one hand what it lost with the other.

The era of wildcat bank note issue, both in this country and abroad, brought support to Adams's views. The ensuing struggle to recover, as a sovereign prerogative, the monopoly of the issue of fiduciary money had an early sequel in the abolition, or governmental assumption of the right of issue, of practically all *tangible* forms of fiduciary currency.<sup>20</sup> The celebrated Bank Act of 1844 practically outlawed any new issue of tangible fiduciary money other than subsidiary coinage in England; but the procedure adopted in other countries was rather toward the maintenance of the practice, but only as a governmental or quasi-gov-

<sup>19</sup> Charles Francis Adams, *Life and Works of John Adams* (Little, Brown and Company, Boston, 1854), vol. ix, p. 638.

<sup>20</sup> The limited issue of private bank notes was maintained in the United States, however, until 1935.

ernmental monopoly. Hardly had these reforms been effected, however, with private note issue thus brought to an end, when the development of the checking system led to widespread evasion of the spirit of the legislation.

The differences between bank notes and demand deposits, under the checking system, are little more than formal but, as Professor Dunbar with a not very perspicacious satisfaction points out, the demand deposit, "incomparably the greatest, although the least considered part [of the circulating medium of the United States] . . . eludes the regulations which legislatures so industriously enforce upon the other constituents of the currency"; and "beyond the requirement of a minimum reserve . . . the subject is not touched by legislation, in this country or elsewhere."<sup>21</sup>

#### RECAPTURE OF PRIVILEGE OF PRIVATE ISSUE OF MONEY

In other words, the privilege of issuing money has been recaptured by the banks. The *degree* to which modern banks manufacture the money which they lend is in dispute; but there can scarcely be any question as to the *fact*. A modern discount operation consists of an exchange of promises between the borrower and the bank, each going in debt to the other. So far, however, as the totality of bank promises becomes, and remains, part of the currency, the bank's promises are never called and the bank is in the delightful position of living on the interest of what it owes. The privilege is in no way essential to the lending process. It should be clear that lending and borrowing ought not to change the supply of currency, and that no money should be lent, by private individuals at least, which had not first been saved by someone. There is nothing to prevent commercial banks from lending, as all other financial institutions do, without manufacturing the money they put at the disposal of the borrower. The bulk of commercial bank lending at any time is, in fact, done without the issue (net) of new money. It is the lending which results in a net increment in demand deposits that fails to meet this test.

In the uttering of their uncalled non-interest-bearing promises the banks obtain permanent interest-bearing assets (loans and investments) at no direct cost to themselves and at the expense of

<sup>21</sup> Charles F. Dunbar, *The Theory and History of Banking*, 4th ed. (G. P. Putnam's Sons, New York, 1922), p. 51.

the community at large. Promises can be indefinitely multiplied and, so long and so far as the public is willing to receive and use them as money, there might be no limit on the resources which the banks could acquire if it were not for the legal or prudential requirement of a minimum reserve. The reserve requirement, which was once intended to give liquidity, has largely lost its original significance but has grown in importance as the only, if feeble, check on indefinite currency expansion. It has prevented chaos but it has been far from exorcising the evil spirit of inflation. As time has gone on, a steady reduction of reserves has proved feasible, without invoking immediate disaster, and the denial of a roving license to the banks has thus been compensated by the gift of privateers' letters of marque.

No responsible community, of course, would consciously grant to any citizen, or group of citizens, privateer privileges against its own commerce, and the advocates of the present system refuse to concede that this has been done. They appear to think that banks cannot create "currency"<sup>22</sup> since, as they say, banks cannot lend their deposits. This assertion, which is widely reflected in banking literature, rests on an ambiguity, perhaps consciously cultivated, in the word "deposits." New net deposits (the total for the system) can arise, of course, either from the delivery to the banks of cash derived from non-banking sources or from the uttering of new promises, by the banks, in excess of those redeemed. There is no question that the banks can, if they wish, lend most of the cash deposited with them; and there is as little question that, under existing circumstances, they can lend their promises to a sizable multiple of the cash they retain from such original deposits. It is true that they cannot lend their existing deposit liabilities but they can lend any cash assets involved in the assumption of some of those liabilities and they can, in addition, lend new liabilities created for, and in the act of, making a loan. They do not even have to wait on the initiative of borrowers since, with promises, they can buy securities on their own initiative whenever borrowers fail to

<sup>22</sup> The contention that bank deposits are not currency, since the credit of the offerer of a check is in question, seems wholly casuistical. No one refuses a valid claim on a deposit in a good bank, and deposits are transferred in final payment of debt without an equivalent movement of cash. The scrutiny directed at a check is of precisely the same character as that which seeks to distinguish between good and counterfeit commodity money.

offer them short-term notes in volume adequate to bring pressure on their reserves.

#### EVOLUTION OF THE PRIVILEGE OF MONEY ISSUE

The extent to which the liabilities so created will continue to be currency depends, it is true, upon the persistent readiness of the public to accept them as such. But in the play of use and wont this readiness has steadily grown and, following Gresham's law, the bank-debt money has more and more driven commodity money out of ordinary circulation. When it went out of circulation it went, in large part at least, into the banks and, as a reserve, has increased the power of the banks to issue more of their own debt as money. If nothing but cash were used as currency, the deposits (and assets) of the banks could grow in like measure (through recurring deposits of recurrently lent cash) only on the condition that deposits were left untouched. It is clear that the community would not leave non-interest-bearing deposits indefinitely in the banking system if custom had not turned them into money which could be used without any net withdrawal. The growth of this custom permanently floated a large part of the banks' existing debt and made it possible for them, on their own initiative, to cast a much enhanced volume of debt upon the waters in the hope, on the whole justified, that it would not return. We have thus developed a new and unique species of mortmain.

The ultimate irony in the delivery to the banks of the government prerogative of money issue is present in the pursuit of an inflationary fiscal policy in the form in which modern inflations typically occur, that of governmental borrowing from banks. Interest-bearing government securities are sold to the banks, which pay for them by the simple and practically costless process of writing up a deposit credit on their books. If a government is bent upon an inflationary fiscal policy it would seem only common sense that it should get the seigniorage on the new issues of money through which such a policy is carried out. Otherwise it is put in the ridiculous position not only of divesting itself of its prerogative in favor of the banks, and of losing the seigniorage profits on the new supply of money, but actually of paying the banks, in interest-bearing securities, for issuing bank-debt money on its behalf.

The compelling argument for an exclusive monopoly in the government of the power to issue money and, therefore, for the requirement of 100 per cent cash reserves against demand deposits, is the argument from equity.<sup>23</sup> The issue arises only with respect to fiduciary money. Fiduciary money, except as an ephemeral accompaniment of the debasement of coinage, is a comparatively modern phenomenon, and its inequitable implications have been but slowly grasped. Fiduciary, or debt, money is, from the point of view of the issuer, cheap, but it may be very expensive to society at large. It is inherently unstable. It came into general use because it served the immediate purposes of the issuer and recipient. The general interest, which was in any case obscure, had no advocate, and social action has been taken only in alleviation of the more obvious (but not the more important) evils associated with it.

#### NO SINGLE COMMODITY A GOOD MONEY MATERIAL

Even a pure commodity asset money, however, if it is to meet the requirements of a civilized world, must have greater stability of value than any single commodity possesses. The general adoption of the precious metals as the money material is almost solely attributable to the fact that they were, at the time, the commodities which offered as stable a medium as the current technique could provide.

A fixed price for gold never, of course, made gold immune from the economic forces affecting all other commodities and changing their *relative* values. The *price* of gold did not vary—but its value, in terms of commodities, was far from constant. This eventually made unmanaged gold intolerable, as the unit of account, and resort was had to “management.”<sup>24</sup> Whatever nominal arrangements were preserved, such management was, in reality, an abandonment of a gold standard in favor of the standard used as the

<sup>23</sup> Were the privilege of issuing money taken from the banks there would be no reason why competition in banking should not be perfectly free rather than, as now, a partial monopoly which may be invaded only if an official certificate of necessity and convenience can be obtained. With the removal of the privilege of issue of money, moreover, the demand for the socialization of banking, which, in the present situation, has much to commend it, would be deprived of any validity.

<sup>24</sup> On the alleged automaticity of the gold standard, in recent decades, cf. Charles R. Whittlesey, *International Monetary Issues* (McGraw-Hill Book Company, New York, 1937), chap. III.



criterion for managing the metal. This criterion has always been so vague that it is the plain truth to state that we have, at present, no intelligible monetary standard and that the "managers" of our currency have no clear idea of what they are trying to do. It is small wonder, therefore, that our pecuniary economy works haltingly.

The attempt to manage money, badly carried out, involved a half-hearted shift from a single commodity as the money material to debt money more or less closely linked to a composite of commodities as a vague criterion of the level of value at which the monetary unit should be held. The clear logic of the attempt requires the direct use of an extensive list of commodities as a monetary base. By so doing, the making of money, in both the literal and the figurative sense, would be correlated with the making of goods and the absurdities of a society afraid of production would disappear.

While a 100 per cent reserve against demand deposits is required for complete equity in the monetary system the social interest would not be very seriously invaded by the issue of bank money, on partial reserves, provided inflationary governmental or private borrowing were prevented and fluctuations in price levels did not occur as a result. Competition among the banks forces them to disgorge, in various types of service to the public, a large part of the excessive profits they would otherwise make from the issue of new money. A commodity reserve system, which would stabilize the price level, would therefore accomplish most of its benefits even if the present system of partial reserves against demand deposits were retained.

#### TRANSITION TO COMMODITY RESERVE MONEY

It is, in fact, quite possible to introduce all the essential elements of a commodity reserve system without any significant disturbance of existing monetary arrangements. A suggested program for its introduction in the United States follows:

1. Commodity reserve money shall be initiated on the appearance of a fall in the price level of basic commodities below a designated figure.
2. All commercial banks shall, as of that date or earlier, be required to join the Federal Reserve System.

3. The Board of Governors of the Federal Reserve System shall be given power to fix at its discretion the reserve ratios required of member banks (the present *proportions* among the reserves required of central reserve city, reserve city, and country banks may be maintained).

4. All member banks shall be required to redeem their current deposit liabilities, on demand, in cash or in checks against their reserve balances at the option of the holder.

5. The Federal Reserve Banks shall be directed freely to buy, at the prescribed dollar value, warehouse receipts representing composite commodity units and to pay therefor in Reserve Bank deposits transferable only to a member bank.

6. After a stated reserve of these receipts is acquired by the Reserve Banks as a whole, each of the Reserve Banks shall be required to redeem its liabilities, on demand, in commodity units or gold at the option of the holder.

7. A progressive tax shall thereafter be imposed on the Reserve Banks as a whole whenever the total of their commodity reserves falls below the stated figure. (Distribution of the tax as among the several banks should be in inverse proportion to the ratio of their commodity reserves to their demand liabilities, and rediscounting, by any one of the Reserve Banks for another, should be subject, as at present, to the dictate of the Board.)

#### ARGUMENT FOR METHOD OF TRANSITION

There will be no objection in informed and unbiased circles to the proposals that all commercial banks be brought into the Federal Reserve System and that the Board of Governors of the Federal Reserve System be given discretionary power to fix the reserves required of member banks. No really effective control of our monetary and banking system is possible without these measures and they have been repeatedly championed in the most conservative quarters. The status and practice of member banks is not otherwise altered in the program above outlined.

All of the present powers of the Federal Reserve Banks and Board, moreover, are retained in their existing form. Discount policy and open-market operations would be handled as at present. The progressive tax on the reduction below a stated minimum in the Reserve Banks' holdings of commodity reserves is the coun-

terpart of the traditional tax on a reduction of their cash reserves below a required percentage of note or deposit liabilities.

No conservative in monetary policy will deny that the Reserve Banks should be held to a redemption of their liabilities in *something* and, under the proposals made above, there could never be any pressure on the Reserve Banks to do more than has always been necessary to prevent inflationary price movements. If, on the other hand, a deflationary situation should develop, the Reserve Banks would automatically acquire reserves through the delivery to them of commodity units for which the outside market would, at the moment, be unwilling to pay the designated price. This would give them the fullest warrant for a resolute policy in expansion of credit since they would have acquired redemption assets in the process.

The rights of a holder of paper money, or of the demand liability of any bank, would be greater than they have ever been in the past. If he desired redemption in gold he could have gold but if, as is in many cases probable, he should prefer commodity units, they would be at his disposal.

All of our present types of money and bank credit could be maintained along with the free purchase of gold at the established, or any desired, price. There is small reason now for refusing to redeem our money in gold and there would be none after a supplementary reserve in commodities had been set up. No private hoarding of gold, or any other type of money, could then lower the price level of commodities in the reserve or prevent their production in unimpaired volume. The very pressure on their price level, arising from the hoarding of gold or other types of money, would lead to an automatic expansion of commodity reserves in compensation of any reduction that might occur in gold reserves through redemption of currency in the metal. Such an expansion of commodity reserves, through the sale of commodity units to the Reserve Banks, would be an assured and self-liquidating accompaniment of incipient depression. Contrariwise, bank credit expansion on the basis of deposited gold reserves would be checked short of inflation through reduction in the commodity reserves, by redemption, to the level appropriate to the maintenance of stable prices.

If present policies on gold, are maintained, an increase in the reserve ratios required of member banks is clearly required as a safeguard against indefinite inflation. But, if discretionary power

in this matter is given to the Board, it could prevent the current stocks or any probable increment of gold from exerting such an inflationary influence as would provoke the draining away of the reserves of commodities once the latter were established. The same safeguard is effective against reserves arising from the deposit of governmentally issued cash, unless, indeed, the government should proceed to put out fiat money in such volume as to render even a 100 per cent reserve requirement powerless to prevent a rising price level. Over all other present sources of reserve funds the Reserve Banks have complete control, on the proviso, again, that the government refrains from *forcing* them to put Federal funds at the disposal of member banks through the direct purchase of government securities or the like.

A government bent on inflation cannot, of course, be stopped by *any* prescribed monetary policy. If commodity reserves were available at the start of such a move the redemption of commodity units would prevent any increase in the price level of the reserve commodities until these reserves were exhausted, but any such reserves might, of course, disappear if the government persisted in offsetting the ensuing decline in the volume of money with new issues of other types of actual or potential Federal funds. If, however, after commodity reserves were established, inflation were prevented by a credit policy designed to forestall their exhaustion, gold, as well as commodity, reserves would synchronously be protected.

Regardless of any reduction in gold or non-commodity reserve funds, however, no deflation of the price level of reserve commodities, no substantial deflation of the price level of other commodities, and, in these circumstances, no shortage of reserves in general, would be possible so long as free minting of the reserve commodities was maintained.

The introduction of commodity reserve money in the manner proposed forgoes the complete automaticity which is one of the real virtues in a wholly unadulterated commodity certificate money. Such completely automatic action, always in the appropriate direction, would entirely remove the possibility of arbitrary official interference. But objection to any such scheme would no doubt be taken on the ground of lack of elasticity. This objection would be even more strongly urged if a 100 per cent reserve of

commodity certificates were required against member bank demand deposits. Such a requirement would, moreover, be expensive. There is, therefore, much to be said for the retention of such techniques as have been empirically tested and found reasonably satisfactory.

If, then, holding to what we now have, we merely require the Reserve Banks to add to their existing functions the free receipt of commodity units against Reserve Bank deposits, and the redemption of all forms of money in such units on demand, we can count on all the benefits which commodity reserve money promises, provided only that our monetary authorities are entitled to a minimum of confidence and are given the powers universally regarded as necessary to the control of *any* type of monetary system. So much reliance on the principle of administrative discretion, and no more, would not appear to be dangerous.

#### INTERNATIONAL BENEFITS OF THE SYSTEM

The establishment of such a system would not only banish the fear of production which now so frequently afflicts us but would remove that aversion to imports which bedevils international commercial relations under traditional arrangements. With free movement of gold, and its unlimited purchase at a fixed price, the situation in monetary exchange markets would not differ from that which has hitherto prevailed. The establishment of an unlimited demand for reserve commodities, with assured repercussions on the demand for commodities outside the unit, would, however, eliminate the feeling that imports were crowding domestic production out of the market and would permit a free and productive international division of labor. "Transfer" difficulties in connection with international payments would all but disappear.<sup>25</sup>

<sup>25</sup> It is a matter for melancholy reflection that the pecuniary institutions of, and vested interests in, the victorious Allied and Associated countries frustrated the payment of reparations by Germany, and was a powerful factor in preventing the repayment of the intergovernmental debts held by the United States, after the war of 1914-1918. Under economically comic institutions it was conceived that it was indeed better (even from a selfish point of view) to give than to receive. The (quite rationally inspired) gifts which, in the form of loans, we made to our Associates during and after the war were therefore capped by (wholly illogical) gifts to Germany in the decade of the '20's. These latter gifts took the form, first, of purchases of marks which rapidly lost any value they might have had at the time of purchase, and, secondly, of gold, or bonds of German governments,

## THE RESULTS OF AN UNLIMITED DEMAND

In wartime the fear of production is supplanted by a greater apprehension of the consequences of failure to produce. In wartime there is, in consequence, no tendency to limit output and it then frequently happens that, until Moloch begins to swallow a very large part of the total output, the population is better provided

ecclesiastical organizations, and business corporations, which were later partly or wholly repudiated through the refusal of the German central government to permit the transfer of funds from Germany to the outside world.

Even under a gold standard (1924-1931), the Germans, unlike the Allies, felt no difficulty in the receipt of gifts of goods since, in this period, the gifts, in practice, cancelled reparations. (It is a mistake to suppose that the Germans ever made any substantial payment of reparations, net.) The gifts therefore occurred without any great excess, in Germany, of commodity imports over exports. But, after the advent of the Nazis, and the repudiation of any even formal obligation on reparations, the Germans again found no difficulty in the receipt of imports since the deflationary tendency of commodity imports had been nullified in Germany by the abandonment, in that country, of gold as a monetary material along with the whole set of financial institutions appropriate thereto.

It is small wonder that the Germans are contemptuous about gold since they built up a mighty military power not only without gold but at the expense of their potential (now actual) enemies who fondly believed that their stores of gold were a great source of strength to the possessor. Mr. Chamberlain's trust in the potency of what he conceived to be the financial arsenal of Britain was tragic as well as ridiculous while the policy of the United States in buying, at a high fixed price, the gold of Germany, Italy, and Japan armed those powers, at our expense, for the assault on all that we hold dear. The proceeds of the sales of all but useless gold by the totalitarian powers were used for the purchase in this and other countries of the panoply of war and, in spite of these gifts, the Axis powers constantly blamed the outside world for what they, disingenuously and falsely, alleged was a conspiracy to deprive them of foreign exchange. (That is to say, they would have liked to have had more foreign exchange to finance still greater purchases of armament abroad.)

Whatever one may think of their practices (they were those of gangsters) they were, at least, not stupid. Germany, and to a lesser extent, Italy and Japan, had exorcised that fear of production, and of imports, under which the "pluto-democratic" world was suffering. They thus grew strong while the democratic countries were bleeding themselves into an anemia from which they are only now slowly recovering. Whatever the outcome of the present conflict, moreover, one may predict with some confidence that unless the fear of production and of imports, in the democratic world, is permanently banished (not merely dislodged, temporarily, under the pressure of actual hostilities) there can be no hope that democracy will for long be able to ward off the attack of those who have, so far as can be seen, permanently rid themselves of the quite unnecessary, but lethal, disease which capitalistic countries have up to now cherished rather than ruthlessly rooted out.

The disabilities which the traditional system imposes upon its adherents are further clearly brought out in the history of foreign trade in the '30's. The tradi-

with the ordinary means of subsistence than in the so-called piping times of peace. This is an absurd situation and clearly calls for the establishment in peace of the same unlimited demand that is characteristic of war.

The preeminent task in the release of productive power is to transfer desires into demand by removing all institutional obstacles

tional pecuniary mechanism was then replaced, in many countries, by the direct barter of goods as the sole means by which mutually advantageous trade could be carried on. In other words, reciprocal preferences for liquidity had prevented trade which both parties desired and which, when actually effected without the medium of money, left each as liquid as he had been before the trade took place. Under perverse pecuniary standards money had thus ceased to perform its original and preeminent purpose of facilitating trade and had, instead, come to obstruct it. In order to break the hold of a clearly imbecile system it was necessary to resort to primitive, and even confessedly barbarous, methods of trading which were so awkward as to have been spontaneously abandoned when money, in its pristine efficiency, was invented, but which were much better than the nullification to which a corrupted pecuniary system had led. An obviously better expedient is to adopt an improved form of money but this runs counter to immensely obstructive use and wont.

Not only the gold standard, of course, but any pecuniary system under which the desire for liquidity is permitted to inhibit production and import, stands under indictment as a system which favors those who are astute in "ambushing the community's loose change" rather than those who produce real wealth. The Germans lost the (first) military phase of the war that has been going on since 1914 but they incontinently won the non-military phase which followed and, regardless of the immediate outcome of the second military phase, will, as noted, win again if their opponents do not shake off the self-imposed fetters of which the Germans, largely by lucky accident out of apparent misfortune, have rid themselves. It is perhaps not unfortunate for the enemies of the Reich, on the other hand, that Teutonic aggressiveness thrusts the Germans, prematurely, into warlike adventures in which romantic ambition tends to override cold-blooded and precise calculation. The latter quality is by no means absent among the Germans but is wont to succumb to illusions of grandeur.

Under a commodity reserve system, the receipt of imports and the lowering of tariff barriers could, no more than production, ever be deflationary or provocative of any sustained unemployment. The universal, more or less unconscious, but powerful support of a policy of high protection, which has been a result of the fear of production and of imports, would therefore tend to disappear. The barriers to trade—both an effect and a cause of warlike sentiment and a strong contributing force to world impoverishment—might then, perhaps, be levelled wherever, at least, a workman-like philosophy retains any hold. The obstruction to a lowering of tariff barriers (which lowering, under traditional monetary standards, has always been deflationary and for that reason dreaded) would give ground before the unlimited market for the goods in the monetary unit. A possessor, anywhere, of large stocks of any good (whether these were within or outside the monetary unit) could always, in the open market, exchange any part of his stock for the composite of goods in the monetary unit and could liquidate the latter by transfer of title to the mint of the country of commodity reserve currency. Such a country would, thus, almost in-

to that process. It may be that the unlimited demand for the commodities in the monetary unit, even with such repercussions on the demand for other commodities as may confidently be expected, would not always be adequate to provide immediate full employment. In this case it might be necessary to supplement commodity reserve money with some such arrangements as those proposed in the early part of this chapter and, perhaps, with a limited program of *ad hoc* public works.<sup>26</sup> There is, in any event, no possible justification, or any necessity, for the persistence of conditions under which a large number of competent men are involuntarily unemployed. Even the immediate "cost" of employing them can be all but eliminated and there is, in fact, nothing so costly as keeping them idle.

evitably come to occupy the role of Britain, in the nineteenth century, as banker for the world.

The tariff is the original source of discriminatory interference by modern states and, so far at least as tariffs are granted as a result of pressure on the part of those who will benefit thereby, the state then abandons its appropriate function of providing a fair field and no favors and aligns itself with one sector of the public against the rest. The reduction, or abolition, of protective tariffs is an effective means of combating private domestic monopolies of which the tariff may be regarded as, at least, the *foster* parent. Free trade, an important phase of freedom in general, has been long honored, in most countries, in the breach of it. But when the ruinous results of this, and other, restrictions on freedom could no longer be ignored, the cry arose that it was competition (and not the lack of it) which was causing the difficulty and that the remedy was still more restriction until, eventually, everything was brought under rigid control. It is no accident that the final excesses of totalitarianism had their inception in the control of foreign trade. The extension of the area of unrestricted trade would mean such a reduction in the economic importance of political boundaries as is indispensable to a free and peaceful world.

<sup>26</sup> The possible usefulness of complementary stimuli to demand would diminish progressively with the number and economic importance of the commodities in the reserve. With an *infinite* public preference for liquidity the only commodities that would be produced would be the commodities in the reserve. It would be a lengthy and distortionary process to shift all production, temporarily, to these lines, especially if they were few in number. This is, of course, an extreme case, involving the assumption that people with quite adequate purchasing power will go starving and naked, but it points to the *logical* possibility of more or less temporary stoppage of the non-reserve-commodity industries. The impulse to overcome this stoppage would be disproportionately enlarged with every expansion in the coverage of the commodities in the reserve. With a large amount of new purchasing power being issued against the production of commodities which do not issue on to the markets (reserve commodities), the propensity to consume, even if temporarily constricted, would check any tendency toward depression, in the non-reserve-commodity industries, before the slump had become acute.



## DEFECTS OF EXISTING MONETARY SYSTEM AND THE REQUIREMENTS

The existing monetary system could scarcely work more effectively to frustrate men's efforts if it had been deliberately designed, by some malevolent genius, to that end.<sup>27</sup> The primary functions of money are to serve (1) as an accounting unit, (2) as a bearer of options, and (3) as a stimulus to production and trade. As an accounting unit money must be of predictable value since otherwise all inter-temporal transactions become a gamble and the essential basis of a civilized economy is undermined. As a bearer of options the retention of money by individual holders is frequently a necessary part of foresighted individual planning, but this must be compensated if the economy is not to be brought to wreck by hoarding. As a persistent stimulus to production and exchange a given volume of money must either be kept in steady motion or the fluctuations in its movement must be compensated with correlating increases and reductions in volume immediately translated into flow. No money we have ever had meets these tests. Commodity reserve money does. It would give to enterprisers the steady flow of receipts, corresponding to outlays in the productive process, which is essential to the maintenance of stability in the prospects of profit. It would thus replace the vicious or broken circle of present arrangements with a system under which the full potential of the productive power of the community could be brought to summation.

## THE EQUATION OF SAVINGS AND INVESTMENT

It will later be contended that, if full employment were steadily maintained, any tendency for savings to outrun investment would disappear but, even if it were to persist, it would under a commodity reserve money do no particular harm. The monetary supply, coincidently with an expansion of the reserve, would then be steadily enlarged, without inflation of prices, in the precise degree necessary to balance the excess of savings over the sums devoted to investment. The savers would then pile up unspent monetary accumulations, without any deleterious effects on production. This would minister to their desire for power without in the least injur-

<sup>27</sup> For an account of some successful, unorthodox, experiments with money in colonial days cf. Richard A. Lester, *Monetary Experiments* (Princeton University Press, Princeton, N.J., 1939), *passim*.

ing the social welfare. Sooner or later, nevertheless, a reversal of the tendency could be expected, especially under the inheritance laws proposed in the succeeding chapter. As expenditures were made, in excess of current income from production, prices would begin to rise, reserve commodities would be withdrawn, and a homing tendency in the hitherto unspent money in private accumulations would develop. When it came back to the monetary authorities, its retirement from the monetary stream would presently bring expenditures into equality with the income accruing from current production, and the reduction of the reserve would cease.

The principle of storage has been the sole reliance of the individual in providing against the vicissitudes of life. In a non-pecuniary society storing could be done only in the form of goods; individual storing was therefore synonymous with social storing. When, however, it became possible for the individual to store pecuniary claims against society there was, when these pecuniary claims were acquired, no necessary concomitant increase in the goods in which social storage can alone take place. On the contrary, the volume of durable, and indeed all, goods was reduced by the individual's failure to expend his income as it was received. The result was alternate economic stagnation and a fevered activity in a necessarily vain attempt to meet, out of current production, the stored pecuniary claims of individuals when they were presented. To prevent this disastrous sequence society must store in goods when individuals store in money and release the goods when the individuals release the money. The principle of storage would then be used to avert social vicissitudes as it is now solely used to avert those which directly, and exclusively, affect single individuals. An *argumentum ad hominem* may, perhaps, be made when we consider what would have been the difference in our current situation if, instead of piling up, to the benefit of our enemies, quite useless and even pernicious reserves of gold, we had accumulated even a fraction of their "value" in reserves of industrial raw materials.



**PART III • ECONOMIC INSTITUTIONS:  
DISTRIBUTION OF THE FRUITS OF POWER**



## CHAPTER VI

### *DISTRIBUTION OF INCOME: PROPERTY AND INHERITANCE*

#### GENERAL DETERMINANTS OF DISTRIBUTION

**T**HE aggregate income of a society is conditioned solely by the productive and trading powers of its members but the distribution of the income is determined by the location of more general power. An individual's power to command income is partly a matter of his true productive capacity but is quite as largely an outcome of the existing social "arrangements." The imputed value of any service, or of any "factor" in production, is what the offeror can get for it in the prevailing institutional situation, but what he can get for it depends very largely on the institutions prevailing.<sup>1</sup> If men get what they are "worth" because they are "worth" what they can get, a nice problem in ethics and economics gets a neat rhetorical solution, but only if the circularity of reasoning can be forgotten.

The fact is that the power to inhibit production may be quite as profitable to its possessor as the power to further it and, if economic worth is measured by the payment that may be exacted for any "service," a nuisance value is as estimable as any other.

The robber baron in his strategic castle commanding an important waterway "contributed" to production by letting certain traffic pass. His castle had therefore a high rental value which, in addition to the payment for his own "labor," came out of the fees he was able to extract for his "services." Similarly the modern gangster exacts payment for "protection" against a danger which he himself creates. Only a crazed dialectician would assert that such "services" were, or are, in any significant sense, "worth" what they command, since production would be greater without than with them. The divergence between merit and reward, moreover, is by no means confined to cases as striking and opprobrious as these. A cynic might, for instance, assert that the large fees paid to some lawyers are given for the solution of puzzles made intricate by the verbal ingenuity of the lawyers themselves.

<sup>1</sup> Of these institutions the laws of property, and the presence or absence of free competition, are the most important.

## IMPUTATION OF PRODUCTIVITY

The use of a broad and navigable river freely open to all may, by facilitating territorial specialization along lines of comparative advantage, be of great importance in increasing total production. The users of such a river would, however, never attribute to it any of the gains they made in the trade which it transported but would regard such gains as entirely due to their own efforts. The river is, under these circumstances, not a "factor of production." Let it be partly or wholly appropriated, however, by anyone in a position to bar passage upon it, and it could be made a source of income. It would then become a "factor of production" and would have, by imputation, a "value" which it did not have when its use was free.

No non-human factor of production receives any net income but such income as is *attributed* to non-human factors goes, in fact, to their owners.<sup>2</sup> The institutions covering the ownership and use of property are therefore a highly important determinant of the distribution of wealth and income. Whether or not anything is "productive" and, if "productive," the degree of its "productivity," is often less a matter of its inherent properties than of the character of these institutions.

Let us take some further examples. If each of an isolated group of agricultural producers, associated for mutual protection against the violence of any of them, should have free access to as much land of a given quality as he could cultivate, the varying returns to the several members of the group would be regarded as, in their entirety, labor incomes and, in no part, as a return on property. The land would have no present value. But, if private title to specific pieces of it were established, and such a number of pieces were engrossed by a single individual as to make land of that quality hard for others to get, portions of the engrossed land could be leased for a substantial share of their product.<sup>3</sup> This engrossing might take place, without any violence or deception, through the processes of trade, finance, dowry, or inheritance in the forms now widely prevalent.

<sup>2</sup> The recipients of this income may, of course, have it taken away from them by more or less violent action on the part of those who can exert power over them but, if this is consistently done, the nominal holders of the property are merely collection agents for the real owners.

<sup>3</sup> The remainder might very well be used by its owner as a "hunting preserve."

If there were no increase in population it would be highly profitable to hold a large part of the engrossed land out of use so as to improve the return on the leased portions but, if population should begin to press upon the total resources available, this would not be necessary. In any event, the holders of all land would put a valuation upon it, equal, unit for unit, to the capital value of any leased acres, and they would think of the very same income which they had formerly considered a wholly labor income as now partly a labor income and partly a return on their property.

#### EFFECTS OF SOCIAL DISINHERITANCE

When all land had been engrossed, the only bargaining power left to "free" but disinherited individuals would be the power to withhold their labor and to refrain from bidding for the use of resources. Since the exercise of this power by any individual would condemn him to starvation, he would be ready to work, if necessary, for mere subsistence wages or would bid such high prices for the use of land as to leave him nothing but subsistence from its product. His labor would then not be very "productive" and subsistence would be all that, in these circumstances, his labor would be "worth." This is the lower permanent limit on the wage level since men would presumably prefer to starve idle rather than working and, in either event, the supply of labor would be reduced and the fall in wages would thus be checked.

The disinherited would not have to work for so low a wage if the competition for their services, or for their bids as lessees, was keen. If, however, any conjuncture should develop in which the fruit of the labor of some of them was of no value to those in a position to furnish access to the sole means by which it could be made effective, they would be deprived even of such power as would otherwise arise from the threat to withhold their labor. They could then get no present income at all. Their labor, could they find the means to exert it, would yield a product valuable to them but not to anyone who had the power to determine whether the product should, or should not, come into being. This is similar to the condition which prevails in periods of general unemployment in modern economies.

No social organization, based on a potentially productive division of labor and exchange, can merit approval so long as any of



its members receives a lower return, for a given exertion of his powers, than he could have got, without violence or subreption, had he produced for his own consumption under equality of opportunity in the use of the natural resources of the area which the community occupies. No member will, in fact, get less when full employment is attained unless some other members of the community can establish for themselves a nuisance value—and thus reap where they have not sown—or can somehow else attach themselves as parasites on the productive members of the community. With free entry into occupations, free access to resources, and such other approximation to the conditions of free competition as an efficient technology permits, parasitism would, however, be largely eliminated.

#### EXCHANGE A SOCIAL SYSTEM IN A DUAL SENSE

The system of division of labor and exchange under conditions of free competition is a social system not only in the sense that it is cooperative, on a voluntary basis, but that the benefits of improvements in productive power, wherever made, tend to be diffused among the community as a whole. It is, for social purposes, futile to speak of the separate productivity of different factors in cooperative production since it is impossible, with reference to causation, to allocate among them the product of their combination. A group of relatively incompetent mechanics might, by the use of a machine, add little or nothing to the total product while a more competent group might add much. It seems rather a straining of language to say that it is the *machine* that adds much in the latter case but little or nothing in the former and, as is a conceivable conclusion from the use of this concept, that the incompetent workers are more productive than their fellows.<sup>4</sup> The supplier of the machine, nevertheless, would be able to exact a much larger return for its use by the mechanically competent men than for its use by the others, and the competence of the former might thus be of practically no material benefit to them.

If, however, the supply of machines were indefinitely multiplied by competing suppliers to the point of equality of return in this

<sup>4</sup> This conclusion would follow from imputation of productivity if the mechanically incompetent workers could have produced more than the mechanically competent when neither had the use of the machine.

with that in other pursuits, the demand for the services of mechanically competent workers would raise their returns, relatively at least to that of their mechanically incompetent fellows, and the productivity imputed to the machine would fall. The strategic position which the original supplier of the machine had held would then be eliminated and the mechanically competent workers would acquire a strategic position they had not hitherto enjoyed. The latter strategic position would, in turn, be undermined as the hitherto mechanically incompetent workers learned to use the machine effectively. Except as consumers of their own specialty, the suppliers of the machine, and the workers who run it, would ultimately get no special benefit from its production and use, while the benefits they would get as consumers would be shared with those who had nothing to do with the introduction or use of the machine. In a similar fashion the users of this machine would benefit from other innovations, and the development of other skills, for which they themselves were in no way responsible.

#### IMPORTANCE OF STRATEGIC POSITION

Strategic position, then, rather than inherent productive power, is of supreme importance in the distribution of output, and strategic position is often a matter of privilege or accident. It thus might seem that rewards have little relation to desert, but it should be remembered that the innovators, and the earlier possessors of special skill in the use of the machine to which reference is made above, were for a time differentially rewarded, and that a similar, but more lasting, differential reward will accrue to anyone who can develop and maintain a productive skill which his fellows cannot match. Social goals are approximated in the degree in which strategic positions accrue to those who deliver a superior quantity or quality of the several types of truly productive service and rewards are thus correlated with natural rather than with artificial scarcity.

Imputed productivity is gauged by the damage that could be done to total output by the withholding of successive increments of a factor of production. Much here depends upon the size of the increment in question. If ownership of portions of the supply of any factor is widely diffused, the withholding by any individual of the portion of the supply within his control will not do much harm

to total production nor appreciably injure anyone but himself. But, if ownership of any factor is concentrated, the withholding of a sizable part of the supply may not only do no harm to the holder but may redound to his great advantage, and to the damage of buyers, in the greatly enhanced price of so much of the factor as the engrosser finds it to his advantage to release. It is a function of the state in coercing coercions to prevent any such concentration in the private ownership of any single factor of production as to enable the engrosser to secure a strategic position facilitating such exploitation of consumers.

The essence of free competition is the persistent elimination of the strategically favorable positions that arise through accident or privilege. If all strategic positions which issue out of obstruction of supply are nullified, the relative scarcity in the supply of any remaining strategically situated factor of production will increase its relative price but the consequence of this comparatively high return will be an augmentation of absolute supply which will progressively deprive that factor of its strategic advantage. The result will be a correlative progressive improvement in the position of those factors of production which are currently in the worst situation. Provided full employment is maintained, free competition must, therefore, with every improvement in productive power, issue in a steady rise in both the absolute and relative status of those human factors of production which are at the moment least well rewarded.

Under perfectly free competition the ability to deliver a superior quantity or quality of a given sort of service would, of course, always command a premium over less distinguished service of the same sort. So far as this ability measures the varying inherent or self-developed powers of individuals, the differential will be uneliminable and will correspond with socially beneficent power.

Different *types* of service, moreover, will command differential rewards as a kinetic situation in technology or demand places one or another of them in a strategically favorable position. The socially most productive action is then to increase the supply of the strategically favored service and, as this is progressively done, any purely fortuitous strategic advantage disappears. The upshot is a persistent strategic advantage for those with the ability to supply a superior quantity or quality of the steadily more urgently

needed and persistently required services. With equality of opportunity these individuals will again be such as possess and exert superior economic virtues, that is to say, socially beneficent power.

CONDITIONS OF CORRESPONDENCE OF STRATEGIC POSITION  
WITH ECONOMIC WORTH

The only solution of the problem of distribution consistent with rewards in consonance with socially useful power is, therefore, that of a competition in which strategic positions are uniquely correlated with inherent economic virtues under conditions which permit of no *artificial* restriction of supply.<sup>5</sup> The social interest demands that all strategic positions other than those deriving from the ability and willingness to enhance the quality or amount of a given productive service be broken down, and this requires equality of opportunity of entry to any socially useful occupation. On the negative side it implies the denial to anyone of the power to withhold part of a potential supply except at his own expense.

Freedom in the economic sphere is the freedom to enter the occupation which, with due regard for *all* of the rewards and repulsions it may have for the individual, appears most attractive to him. This will be the occupation in which he can exert what powers he has in the most fruitful way, certainly so far as his own and, typically, so far as the social interest is concerned. With freedom to deliver any service, the relative scarcity of the currently more highly rewarded services will be reduced as fully as ineradicable differences in powers and inclinations permit; the rewards for these services will then fall; and the social group will, in consequence, share in the fruits of the exerted powers of its more productive and therefore, under free competition, its more strategically situated members. The latter, nevertheless, will always receive more than they could have got for their talents without the specialization which the social organization furthers, since they would otherwise refuse to sell their services and would devote them to production for their own use.

<sup>5</sup> *Naturally* scarce services are those for which there is an urgent demand and a supply which, as a result of biological or moral variations inherent in humankind, is relatively short. The biological or moral qualities important for this purpose are, of course, those which issue in economic virtues.

## PROPERTY IN LABOR AND PROPERTY IN GOODS

Productive services are of two general types, personal services and the services of objective property. The supply of one is as important as that of the other. Property in personal services presents few difficulties, but property in goods, and therefore the control of supply and title to the return on them, offers some knotty problems in the distribution of power and its fruits. In a community organized on social principles, and as such inimical to slavery, no question can arise with regard to the ownership of personal services or to the title to what can be got from their use. Even Hobbes, who was certainly no democrat, set down as a natural right "the Liberty each man hath, to use his own power, as he will himselfe, for the preservation of his own Nature."<sup>6</sup> Locke was more specific in asserting that every man has a property in his own person, to which nobody has any right but himself, and that the labor of his body and the work of his hands are properly his.<sup>7</sup> Locke clearly intends to say that the *fruits* of a man's labor are properly his but, since a man can ordinarily exert his labor only upon things, the determination of what share of the results is attributable to the labor, and what to the things on which it is exerted, becomes crucial. It has already been noted, in the illustrations of the waterway and in that of the agricultural laborers, that this is, in fact, dependent upon variable social institutions. When title to things lies elsewhere than in him who exerts his labor upon them, the amount that can be obtained for the personal services depends upon the amount which the owner of the property can extract for its use, and vice versa. Provided the property is of a type which could be freely expanded at no cost except that of labor and abstinence, and provided the property had been acquired solely through such expenditure by its present possessor, no distributive difficulty arises. This, however, can obviously not be true of natural resources to which no one can have an original title derived solely from the exertion of his labor or continence in consumption. But more or less scarce natural resources are essential to the production of practically all goods. The title to many

<sup>6</sup> Thomas Hobbes, *Leviathan* (Cambridge University Press, Cambridge, 1904), chap. xiv, p. 86.

<sup>7</sup> John Locke, *Of Civil Government*, Second Treatise (J. M. Dent and Sons, Ltd., Everyman's Edition, London, 1924), chap. v, §27, p. 130.

other types of objective property, moreover, lies in hands which did nothing whatever to create the property.

No man is wholly indispensable and, with entry into occupations free, the possibility of substitution will ordinarily prevent any individual from acquiring an oppressively large share of total output in payment for personal service of a productive sort.<sup>8</sup> But property in objective goods may give a power to the holders to draw income which has little, if any, relation to their socially beneficent or socially innocuous exertions.

#### ETHICAL TITLE TO PROPERTY IN GOODS

"The principle of private property," says John Stuart Mill, "has never yet had a fair trial in any country. . . . The social arrangements . . . commenced from a distribution of property which was the result, not of just partition, or acquisition by industry, but of conquest and violence: and notwithstanding what industry has been doing for many centuries to modify the work of force, the system still retains many and large traces of its origin. The laws of property have never yet conformed to the principles on which the justification of private property rests. They have made property of things which never ought to be property, and absolute property where only a qualified property ought to exist. . . . Private property, in every defence made of it, is supposed to mean, the guarantee to individuals of the fruits of their own labour and abstinence. The guarantee to them of the fruits of the labour and abstinence of others . . . is not of the essence of the institution. . . . To judge of the final destination of the institution of property, we must suppose everything rectified, which causes the institution to work in a manner opposed to that equitable principle, of proportion between remuneration and exertion, on which in every vindication of it that will bear the light it is assumed to be grounded."<sup>9</sup>

"The essential principle of property being to assure to all persons what they have produced by their labour and accumulated by their abstinence, this principle cannot apply to what is not the produce of labour, the raw material of the earth. . . . When the 'sacredness of property' is talked of, it should always be remem-

<sup>8</sup> The late Walther Rathenau once said that no very great fortune could be built except on the basis of some sort of (artificial) monopoly.

<sup>9</sup> Mill, *op. cit.*, Book II, chap. 2, §3, pp. 208-209.

bered, that any such sacredness does not belong in the same degree to landed property. No man made the land. It is the original inheritance of the whole species. Its appropriation is wholly a question of general expediency. . . . To me it seems almost an axiom that property in land should be interpreted strictly, and that the balance in all cases of doubt should incline against the proprietor. The reverse is the case with property in moveables, and in all things the product of labour: over these, the owner's power both of use and of exclusion should be absolute, except where positive evil to others would result from it; but in the case of land, no exclusive right should be permitted in any individual which cannot be shown to be productive of positive good."<sup>10</sup>

The term "land" in the passage just quoted is, no doubt, to be construed to cover all natural resources. Locke had pointed out, however, that though the earth and all that is therein belongs to mankind in common, yet there must of necessity be a means to appropriate it in some way before it can be of any use or at all beneficial to any particular man.<sup>11</sup> Many natural resources can best be developed under private appropriation and this development may redound to the social as well as to private interest.

#### THE INSTITUTION OF INHERITANCE OF PROPERTY

The key to the dilemma in the partial contradiction between the views of Mill and Locke lies in the laws of inheritance. We cannot compensate the dead sufferers from wrongs of past ages and it makes no difference to present and future generations how property was originally acquired provided it is now and in the future transferred only in return for a *quid pro quo* in the product of labor, foresight, and abstinence. It is a matter of no consequence to this purpose, moreover, whether the property is or is not in natural resources. The inheritor of *any* property may, and often has, exerted less labor, foresight, and abstinence in its acquisition than did the original appropriator of natural resources in establishing his more or less justifiable title to them.<sup>12</sup> Property in natural resources is more likely to permit of the exercise of a

<sup>10</sup> *ibid.*, Book II, chap. II, §§5, 6, pp. 229-235.

<sup>11</sup> Locke, *op. cit.*, chap. V, §26, p. 130.

<sup>12</sup> There were great differences in the equity of these titles. Property may be found or taken from another. It may be acquired on condition of settlement in currently unattractive surroundings or as part of the spoils of marauders.

monopolistic or quasi-monopolistic exploitation than is possible with other types of property, and for this reason may on occasion require special treatment, but, on the assumption that private appropriation of natural resources is not necessarily a social evil, property in them is neither more nor less subject to unjustifiable acquisition than is property in anything else. The fact that industry, in many centuries, has not been able to overcome the inequities of early force is not in any special way attributable to the peculiarities of natural resources but is because old inequities are perpetuated, and new inequities injected into the situation, through the inheritance of property. There can be little doubt that the largest deviation from the principle of distribution of wealth and income according to economic desert arises in this way.<sup>13</sup>

#### INHERITANCE INCOMPATIBLE WITH EQUALITY OF OPPORTUNITY

A substantial part of social income accrues to those who have inherited their property. No matter how free the competition, once the race is on, no equitable result can be obtained if the competitors have not all started from scratch. The inequity of unequal starts is, indeed, likely to be cumulative as a result of the centripetal nature of power.<sup>14</sup> The greatest weakness in classical political economy, after the neglect of consideration of an adequate incentive to productive action under prevailing institutions, was the failure to promulgate the conditions under which the institution of private property might be made compatible with the rights of the individual to no less or more than the fruits of his own labor, foresight, and abstinence. These are the conditions of equality of

<sup>13</sup> The capital value of a given income from inheritable property is much greater than that of the same income from services since such an income is (presumptively) of infinite duration while income from services must die with him who provides the services. It is often maintained that the possessor of inherited property is performing a service by refraining from consuming the property. This is true enough. He is, however, paid for a service he did not perform (accumulation of the property) as well as for that which he does.

<sup>14</sup> It should be noted, on the other hand, that great powers are often developed in the effort to overcome handicaps. This is true even when the handicaps are merely imagined in a persecution complex. Since, as will later appear, an *absolutely perfect* equality of opportunity is unattainable, we can perhaps rely on such imperfections as are uneliminable to stimulate rather than hinder the development of powers.



opportunity, including free access not only to the gifts of nature but to the accumulated knowledge, and other capital, of the race.

The right of bequest might appear to be an integral part of the right of property, in giving to the individual the free disposition of his earnings; yet the dynasties of wealth which the unfettered right of bequest has begotten in the past have been highly destructive of equality of opportunity.<sup>16</sup> The institution of inheritance of property, growing out of the "right" of bequest, has, in every age and state where it has occurred, been a prime factor in maintaining a continuity of socially unwarranted power as well as an indispensable condition of the preservation of caste in its varied manifestations.

Inheritance has paved an easy road for those who have no talent and been brought to bear against those who have. With what one might have hoped was the permanent decline of militarism and superstition, in the eighteenth century "Age of Enlightenment," it became the principal stronghold of privilege and the chief means for the shackling of the disinherited in the interest of a quite irrationally selected elite. In the less rigid caste systems it has, of course, always been possible for individuals and families to move into, or out of, the circle of privilege; but this has never greatly altered the incidence of inequality and does so in a progressively diminishing degree as a society works toward settled conditions.

#### FORMER MODIFICATIONS OF MORTMAIN OF INHERITANCE

In pecuniary societies the most powerful solvent of the encrustation of hereditary privilege has been a shift in the value of the monetary unit. Monetary inflation, by one of several methods, has over and over again been the engine through which fluidity in the

<sup>16</sup> Even where the forms of democracy are well preserved, and there is no forthright corruption, the prominence associated with riches may give a quite undeserved advantage to the possessor of wealth in seeking the suffrage of the people. (This is the case, of course, with other forms of caste privilege as well.) An inheritor of great wealth may convert popular suspicion into laudation by means of more or less conspicuous expenditure along certain approved lines as, for example, charity. In the United States, it is true, wealth has, on the whole, been perhaps a *political* liability rather than asset, so far, at least, as the highest offices are concerned. But this, too, is unfortunate since it is injurious to the republic that a rich man should not have as good a chance for such offices as his poorer neighbor. There is no better case for discrimination against the rich man solely because he is rich than for discrimination against the poor man solely because he is poor. The proper case for discrimination is against unearned riches, not against him whom the inappropriate institutions of the republic confirm in the possession of them.

social system has been restored. There is, of course, small justice in the incidence of inflation, but it cannot be denied that it has often given to intelligent and energetic men of independent spirit the opportunities which might otherwise have been open chiefly to sycophants. If the value of the monetary unit is stabilized, as it must be in any decently organized society, the necessity of a watchful treatment of inheritances will be enhanced.

Escape from, if not abolition of, privilege has at times also been possible through migration to new lands free of mortmain. The rapid advance of such colonies, in comparison with the stagnation or withering that so often afflicts long-settled areas, is an indication of what may always be expected when "common" men are free to exert their full powers, and access to resources is not monopolized. The comparative feebleness of paternalistically guided colonies, to which privilege of one sort or another is transplanted, corroborates this contention. There are, however, few habitable and empty areas left in the world, and escape from mortmain is, in consequence, becoming ever more difficult.

A changing technology has furthermore often loosened the grip of the possessors of property privilege as the relative value of their more or less fixed assets shrank. It is true that this, like other fluid situations, has normally eventuated in the mere substitution of one group of privileged persons for another but, in the process, some approach to equality of opportunity developed. With the development of property in the form of shiftable monetary claims on future income, however, large aggregations of property can be more easily protected against this form of wastage. Changing technology, therefore, no longer provides a ready means of circumventing the mortmain of inheritance.<sup>16</sup>

#### RECASTING OF RIGHT OF INHERITANCE

If it is true that the right of unlimited bequest and the institution of inheritance must always result in a social structure inimical to the basic postulate of all social life, viz. equality of opportunity in socially beneficent or innocuous pursuits—and that this has been

<sup>16</sup> The shrewd management of a large fortune may be made not only advantageous to the owner but a very profitable business for professional managers. Provided a weak holder has sense, or luck, enough to put the management of his fortune in capable hands he can indefinitely enjoy what should be the fruits only of economic capacity, without having done anything to produce them.

so in the past is incontrovertible—then it is imperative upon those interested in maintaining a free economy to recast the rights of bequest and inheritance.

The usual "liberal" approach to the problem has been to make a dichotomy between bequest and inheritance, holding the former to be an inalienable right, consequent upon the more primitive right of the individual to the free utilization of the product of his labor, and the latter to be a privilege rather than a right.

The difficulties which arise in this framework of thought spring both from an inadequate view of wealth and income and a confusion of the product of the labor of an individual in a given state of the arts with the relationship of individual income to the state of the arts through historical time. In a new, competitive, world, with free and equal access to natural resources and the historically accumulated knowledge of society, it seems legitimate to call that which originally propertyless individuals directly produce, or are able to get in a free market for their output and abilities, their labor product, and to treat this income or wealth as private property at their free disposal. Within a given generation the thus resulting distribution of wealth would be ideally in accord with the principle of equality of opportunity. Conceived historically, however, neither the income of any single generation nor that of any single individual within the generation can be held to be the exclusive product of the labor of that generation or individual. For every generation is the debtor not only to the genius but to the labor of the past and, apart from such social inheritance, no single generation would rise much, if at all, above subsistence on an animal level. This debt to the past, of course, can never be paid to the rightful creditors; paradoxically enough it can be paid, if at all, only by enlarging the debt to be inherited by coming generations.

The right of bequest is the right to direct the distribution of the social inheritance as between individuals in future generations, and to perpetuate inequalities, presumably based on merit in one generation, through succeeding generations without relevance to merit or performance. Thus we are confronted with the fact that the principles of distribution of wealth, according to the right of equality of opportunity, which apply for a single generation, do not apply as between generations, and that what may legitimately

be considered the exclusive labor product of an individual within a given generation cannot be so considered from the historical point of view.

It follows, therefore, that neither bequest nor inheritance is a right of private property—both are privileges. It may be, and indeed is, socially desirable to grant certain privileges of private bequest and inheritance, but these privileges must always be revocable when in gross violation of the right of equality of opportunity.

The legal basis for this attitude toward the rights of property as between generations is to be found in Blackstone's *Commentaries* where he says that "the most universal and effectual way, of abandoning property, is by the death of the occupant: when, both the actual possession and intention of keeping possession ceasing, the property, which is founded upon such possession and intention ought also to cease of course. For, naturally speaking, the instant a man ceases to be, he ceases to have any dominion: else if he had a right to dispose of his acquisitions one moment beyond his life, he would also have a right to direct their disposal for a million of ages after him; which would be highly absurd and inconvenient. All property must therefore cease upon death. . . ." Blackstone adds: "Wills therefore and testaments, rights of inheritance and succession, are all of them creatures of the civil or municipal laws, and accordingly are in all respects regulated by them."<sup>17</sup>

#### PRACTICAL DIFFICULTIES

It would not, of course, be possible wholly to banish the type of inequity involved in inheritance even if private inheritances should be abolished. Inheritances are in no respect socially worse (in many respects they are better) than gifts *inter vivos*. But the attempt to prohibit even only important gifts *inter vivos* is subject

<sup>17</sup> *Commentaries on the Laws of England* (3rd edition, Clarendon Press, Oxford, 1768), Book II, chap. 1, pp. 10 and 12. Blackstone is here speaking only of "natural" or, perhaps, common law rights. cf. Jefferson's dictum that dead men have no rights.

It is, of course, possible with a color of logic to argue for bequest, but not inheritance, as consistent with equality of opportunity. The case for bequest is certainly stronger than that for inheritance. Though it might seem that the distinction was without a difference it would become important if a limited inheritance by any one person, or an unlimited right to eleemosynary institutions to receive legacies, were permitted, and other receipts from decedents were banned.

to much evasion. It can always be alleged with respect to any gift that it is, in fact, a payment for services rendered and, since no one but the buyer is in a position to appraise the value of a service rendered to him, no want of a consideration for the payment could ever be proved. Gifts could thus always be assimilated to contractual payments and, to prevent widespread efforts in this way to evade the law of inheritance and gifts, some latitude in the provisions is necessary.

The principle of fair persuasion, moreover, is, in the case of gifts *inter vivos*, in partial conflict with that of equality of opportunity. A donor may be persuaded by any of a variety of impulses, good or bad, to make his gift. The persuasion may be perfectly fair, in the sense that no force or misrepresentation is used, but a pure and exclusive gift must, by its very nature, do some violence to equity as between the recipient and his excluded fellows. Yet we can never expect—we should perhaps not even like—such perfect rectitude among men as to exclude all show of favor. Nepotism, in its less revolting forms at least, we shall, therefore, always have with us.<sup>18</sup>

Some inequity is thus bound to rise out of private property, and the distribution of wealth must always fall short of the ideal. The state of limited inequity commands a certain acquiescence since equity is by no means the sole consideration that comes into question in matters of property and inheritance. Inheritance is closely associated with family organization, and the family is still, in many ways, the social "cell." Family tradition and pride is, on the whole, a useful social force (that is, it contributes to social power). So far as inheritance preserves the connections under which family productive power and a warranted family pride may be maintained, it has therefore, even from the social point of view, some compensations.

But despite this and other values of a minor character which accrue as a result of bequest and inheritance, warranting the granting by society of some privileges in this realm, the clear logic of the situation is that in the pursuit of equality of opportunity the gen-

<sup>18</sup> If, however, competition were free, nepotism would be greatly curtailed especially in the form of the privileged position sometimes given in a corporate concern to relatives of its current controllers. Any corporation which, in a freely competitive world, made many concessions to nepotism would, in all probability, be quickly eliminated.

eral privilege of inheritance must be so circumscribed as to be all but abolished.

#### UNLIMITED RIGHT OF INHERITANCE A MODERN PHENOMENON

The case for the abolition of inheritance is further strengthened when it is recalled that only in the modern pecuniary society is it possible to inherit large wealth without corresponding status and duties. There is no requirement on the modern heir to use his legacy in a socially productive manner. In a society of status, rather than of contract, this could never have been true to the same degree. In early Roman law, for instance, an heir took over the liabilities as well as the assets of his forebear and was not permitted to refuse an inheritance when it seemed disadvantageous to him. The history of inheritance, in the most general sense of the term, has thus passed through a series of stages corresponding to the steps in the transition from primitive collectivist society, in which all property was fully or partially socialized, to the modern individualistic society, in which property is desocialized and exchanged on a contractual basis. In this process so-called rights have been emphasized to the virtual exclusion of obligations.

The thesis that, on grounds of equity, inheritance should be vastly curtailed, if not abolished, is far from new. Bentham, in his hostile review of English laws, proposed that all property of an intestate should revert to the state and that the power of bequest should be restricted in the case of testators who had no direct heirs. John Stuart Mill was greatly disturbed by the evils of perpetuation of property rights on other than a functional basis and felt that the inequities of the prevailing system of inheritance were far from compensated by any economic advantages it might have. Since Mill's time there has been a rather steady rain of attacks on the ethical foundations of inheritance until, at present, the case for the abolition of inheritance on grounds of equity appears to be well established.

#### ECONOMIC CASE FOR INHERITANCE

It has not been on the basis of ethics, however, that the principal controversy over inheritance has taken place. It has been on grounds of economy—specifically, the question of the role of the rights of bequest and inheritance in motivating productive effi-

ciency and the accumulation of capital—that the battle has been waged. Many who have professed to favor the limitation or abolition of inheritance for ethical reasons have, on economic premises, thought themselves forced to conclude that the institution of inheritance is necessary if there is not to be a serious loss of economic power in the effort to secure a more equitable distribution.

Before discussing the major problem, of saving and accumulation of capital, some minor observations pertaining to matters of individual inheritance and productive efficiency may be in order.

In earlier days the inheritance of a business from generation to trained generation was probably useful in preserving continuity in managerial skill and in preventing disruption of the business on the death of any incumbent. This has ceased to be of much importance with the growth of the corporation as the predominant form of business enterprise, with the progressive elimination of one-man corporations as operating units, and with the rise of a special managerial class. The corporation is not mortal, in the sense that individuals are, and the days are passing when the death of any one man can have much influence on the value of the securities in which he was predominantly interested.

On the negative side there is no lack of evidence that the transmission of large fortunes is at least as likely to lead to the degeneration of the heirs as to the development of their (presumptively) great economic powers. The tradition of family worth is often sullied and it may readily be turned into a false pride in ancestors the more intense because of the lack of any basis for self-esteem in the current generation. The individual who is certain to inherit a large fortune is quite as likely to fall as much below average in economic efficiency as the man who created the fortune may have risen above it.

These considerations are, of course, inconclusive in relation to the question of the effect of the abolition of inheritance on saving and to that of the effects of that effect. The position taken on this question in orthodox economic thought may be summed up in the following two propositions: (1) saving is desirable per se and necessarily results in capital accumulation; (2) the abolition of inheritance would stifle the desire to save, would stop further accumulation of capital and probably reduce the existing quantity, and would thus lower the total social product. For the sake of a

better distribution of the golden eggs the supply would be impaired and everybody, perhaps, be worse off than before.

In regard to the first proposition, it has often been pointed out that the motives for saving and the motives for investing are quite distinct, and the sum of money funds seeking investment is not necessarily equated with the volume of loans demanded by borrowers. Saving, therefore, is not necessarily desirable per se and it does not necessarily result in capital accumulation. Even if saving always resulted in the creation of capital, however, it would not follow without limitation that saving was per se desirable. At the extreme, we may imagine the *reductio ad absurdum* of accumulation in which each generation lived on subsistence in order that each following generation might reap the then purely hypothetical benefits of an enlarged capital supply. While the process of capital expansion is probably desirable, even in our most mature economies, the question of the rate of accumulation, involving the question of the balance of leisure and effort and the question of the amount of sacrifice a given generation should make for posterity, are not matters to be brushed aside with the simple dictum of "accumulation for its own sake."

#### INCENTIVES TO SAVING

The relationship of the right of bequest to the motives for saving is a much more complicated problem than is generally supposed. The motives for saving are numerous and interrelated and the problem of weighing the respective motives is a difficult, if not an impossible, task. Without, perhaps, doing great injustice to the complexity of the motivations for saving, five principal causes of accumulation may, however, be distinguished. There is (1) the desire to provide for old age; (2) the desire of the breadwinner to provide for his family upon his death; (3) the desire to accumulate capital to engage in extended or new enterprise; (4) the desire to accumulate for the prestige and power which wealth affords; and (5) inertia, in which saving results not from any particular positive motive but simply because the individual's income from inherited wealth is larger than can conveniently be spent.

The first motive would quite obviously be unaffected by the abolition of inheritance. .



The second motive would, in the case of *complete* abolition of inheritance, disappear. It has seldom, however, been seriously suggested that the right of a husband (or wife) to make provision for the needs of a dependent family after his (or her) death be abridged. If such cases were not covered by private provision, they would have to be taken care of by the state—and there would be little sense in taking money out of one pocket of a taxpayer's coat and returning it to another. Minimum inheritances, as indicated previously, should therefore be permitted.<sup>19</sup> If such allowance for provision for family needs is made in the inheritance tax law, there is little reason to assume a diminution of saving for this purpose.

The third motive, accumulation to engage in enterprise, would also seem to be little influenced by inheritance taxation—unless it be supposed that the increased income to be derived from the success of the new or extended undertaking would not be desired apart from the right of bequest. In this connection it is important to note that corporate saving, which is becoming ever more significant relative to individual saving, would not be in any way touched by inheritance taxes. Savings by corporations, in expansion of their own plant and equipment, would be unobjectionable; though, as will later appear, corporation savings beyond this might be offensive.

The fourth motive for accumulation, that of the desire for power and prestige—a motive generally underrated in importance—would probably be affected in some degree by the abolition of inheritance, but precisely to what degree it appears impossible to say. On the one hand, dreams of a money empire extending through time within the family are doubtless important in such accumulations. On the other hand, the mere thrill of contest, and the feeling of importance going with a responsible executive position, provide much of the psychological stimulus for the type of individual here in question. It seems probable that the latter considerations are relatively so strong that the abolition of inheritance would not greatly affect this category of accumulation. This, of course, is only a guess.

In the case of the fifth motive, or rather cause, of accumulation—saving resulting from the mere fact that individual income derived from inherited wealth is greater than spending capacity—it

<sup>19</sup> Specific provisions will presently be given.

is immediately clear that the abolition of inheritance, by reducing the number of incomes out of which such saving is made, will greatly lower accumulation from this source. There is, moreover, perhaps little doubt that this type of saving is now significant in the total figure for the economy.

#### EFFECTS OF REDUCTION OF SAVING

The upshot of this short survey of the motives for saving seems to indicate the possibility that drastic limitation of inheritance would reduce the volume of saving—by how much it cannot be certain. What may this mean for the economy? In the first place, there is no a priori reason for assuming that the volume of saving after the abolition of inheritance will be less desirable from the standpoint of economic welfare than the more or less arbitrary volume of savings made today. Indeed, there is a possibility that the modern economy is suffering from a chronic case of oversaving which would be cured by a reduction in its volume; if this is the case, the reduction in the volume of pecuniary saving might actually result in an increase in social saving, i.e. in real capital, and in income.

In the second place, even if the rate of accumulation of real capital were retarded and even if savings always have some use, a reduction is not necessarily inimical to general welfare. Accumulation is not an end in itself though the scarcity of real capital in former days made it appear so to be. No precise line can be drawn between the *rights* to consumption of the present and of future generations.

In the third place, even if the volume of saving under conditions of equality of opportunity were from the social point of view deemed insufficient, it would be possible to supplement private saving by state saving out of tax revenue.<sup>20</sup> It is doubtful that such an expedient would be necessary but, if it were, it would suffice quite as well as private saving and, from the standpoint of equity, it would be incomparably better than the maintenance of a caste of wealth endowed in unwarranted luxury for the purpose of making society's savings.

<sup>20</sup> cf. Josiah Wedgwood, *The Economics of Inheritance* (Penguin Books, Ltd., Harmondsworth, England, 1939), Part I, chap. 1, par. 10, pp. 44-47.

In conclusion, on the general question of inheritance and economic progress, it may be said that whatever justification, on economic grounds, of the privilege of inheritance may have been present in the past, there now seems to be no basic reason why reform in inheritance should not be undertaken on grounds of equity without trepidation as to the economic consequences. If these should, after experiment, prove to be adverse, the laws limiting inheritance could be relaxed in whatever degree seemed necessary in a compromise of the narrower and the larger equity based on economic progress.

With respect to practical politics it is more important, perhaps, to have justified the trend toward heavier taxation of inheritances than to make a case for their practical confiscation. If the trend continues, at merely its present pace, any adverse economic effects that might be associated with it would appear gradually but obviously. The appropriate compromise could then be attained with a minimum of disturbance.

#### TENETS FOR REGULATION OF INHERITANCE

On grounds of principle, the following tenets for the regulation of inheritance and gifts are suggested:

1. Bequest is a privilege, not a right.
2. The privilege of unlimited bequest may be granted in the case of donations to bona fide eleemosynary institutions,<sup>21</sup> except in so far as it might, at some time, seem necessary for the government to intervene to prevent mortmain.
3. The privilege of private inheritance of the property of an intestate, in the case of those outside the direct line of consanguinity, is unwarranted. All such property should revert to the state.
4. The privilege of receipt of legacies by will should be limited in the case of any individual to no more than the net amount which any direct heir is permitted to inherit.
5. No heir of an intestate should be permitted to receive as a legacy a net amount in excess of the value of a legally designated capital sum. This capital sum should in no case exceed what is deemed adequate, under conditions of prudent investment, to pro-

<sup>21</sup> The definition of a bona fide eleemosynary institution presents difficulties but it would certainly include those institutions dealing with human misfortune as well as with education not confined to a privileged group.

vide an income sufficient for the reasonable comfort of a person who because of age, youth, or mental or physical defect, is wholly incapable of contributing to his own support.

6. The same principles that apply to inheritances should apply to gifts *inter vivos* with the proviso that the total of gifts of capital *inter vivos*, receivable by any individual and maintained intact, might not be in excess of what he would be entitled to take as a single bequest, or legacy, and should be deducted from the amount of any such bequest or legacy which he would otherwise be permitted to receive.

7. No individual should be permitted to receive gifts of capital, legacies, or bequests, issuing from a number of sources, in excess of the total amount that he would be entitled to take from a single source.

8. Certain more or less intimate property, including a modest homestead, should be completely exempt from the operation of the laws.

These principles would not be easy to enforce, but they do not seem to offer administrative difficulty much greater than that which is present in the case of tolerably effective existing legislation.<sup>22</sup> Enforcement of them would not establish perfect equality of opportunity, but it would perhaps go as far along that road as is practically possible and it would greatly curtail the enjoyment and use of a wholly inappropriate private power.

#### EFFECTS OF PROPOSED LEGISLATION

Such legislation would, in effect, secure a recurrent reversion to the state, for redistribution by sale to the highest bidder, of what might well be called the state's patrimony. It would put all members of the state in much the same relative position as they would have had as propertyless entrants upon a virgin area, under an equal division of its resources among the participants in a social compact, for each to make of them what he could to his own advantage. With inheritance treated as suggested, the means to the acquisition of any important resources could come only through the prior exertion of the inherent productive powers of an indi-

<sup>22</sup> The possibility of complete or partial evasion through transfers to a single individual of property scattered over several sovereign jurisdictions is minimized by the current risk attending all foreign investment.

vidual, or through a free (loan) contract with, or the fair persuasion of, such a person. The capitalized rental value of natural resources, and other types of durable property, would be paid, on acquisition, out of "labor" incomes, and the return on such property would then be the mere equivalent of the return on property produced directly by the holder. The value, moreover, of all durable property would be automatically reassessed on the death of the holder. This would prevent the perpetuation of any strategic advantage, arising from changing technology or demand, which could not have been foreseen by the prior purchaser of the property, or his competitors for it, and is therefore a pure matter of lucky accident. All incomes would, then, as nearly as possible, be dependent solely upon the productive efforts of their recipients and would be closely correlated with the exercise of economic virtues. It would, perhaps, be hard to exaggerate the importance of this as a spur to enterprise.

Some such treatment of inheritances is part of the necessary functions of the state and, without it, any pretense of equality of opportunity, and of rewards in consonance with desert, is idle or malicious.

## CHAPTER VII

### *CREDIT AND DEBT*

**D**EBT is an important factor in the final incidence of the distribution of the fruits of economic power. It affects the economic, in contrast with the legal, distribution of ownership of property. In considering debt it is well to recall that credit and debt are opposite facets of the same thing. Miracles are frequently expected of credit by those who forget that credit is also debt. Debt, on the other hand, is often erroneously held to be responsible for grave disasters by those who forget that the obverse of debt is credit. If, instead of saying that credit is the life of trade, we should assert that debt is, the one statement must be as true as the other though the latter does not sound quite so convincing as the former. If, on the other hand, it is contended that society is being ruined by debt we must be prepared to put limitations on the alleged virtues of credit.

Credit and debt, in general, have no immediate material consequences other than to effect a transfer of title to existing resources, from the lender to the borrower, in exchange for a transfer of title, from the borrower to the lender, to a somewhat greater value of presumptive future resources. The difference between the two values is, of course, the interest, or discount, for the waiting and the risk, on the credit-debt. The essential function of credit or, as we may alternatively say, debt, is to put existing resources into the hands of presumptively more productive, or merely more urgent, users than those in whom the title to the resources was vested prior to the debt-credit transaction.

Credit is a phenomenon of time and serves not only to transfer resources from passive to active hands but to effect a better distribution in time of the actual or prospective income of individuals. The former is producer's credit, the latter consumer's credit. Both have their uses, but consumer's credit, in one form or another, is not only useful but indispensable.

Children inevitably consume more than they produce and the same is likely to be true of the aged. The tradition of long ages was for individuals as children to "borrow" from those in their productive years, to produce more than they consumed in the middle span of life, to pay back at that time their former borrowings as

well as make new "loans" to their own children, and to live in their declining years on the repayments of the latter. Some deviation in the latter phase of this cycle of credit is to be noted in modern times where the excess of the individual's output in his productive years is not to the same extent spent on parents but is put by for his own old age in independence of his children. The growth of compulsory old-age pension systems has greatly accelerated this development, and this is but one phase of a supplanting of informal credit transactions by those which take documentary form. The growth of recorded debt is in large part to be attributed to these and analogous transactions.

#### THE AGGREGATE OF DEBT NOT PER SE SIGNIFICANT<sup>1</sup>

The aggregate volume of credit-debt in an economy is, per se, a matter of comparative indifference. It is typical of the modern economy that most individuals are, at one and the same time, debtors and creditors. The man-in-the-street may be a creditor of a bank in which he has a deposit, or of an insurance and annuity company in which he holds certain present values in endowment insurance or contributions to a pension, while he may, at the same time, be a debtor as mortgagor of his house or as a buyer of his car on the installment plan. The total of these obligations, on both sides, may be much more than his present net worth or unworth.

Business corporations have no assets without corresponding liabilities. All of their property is paralleled by a debt to their stockholders if not to other creditors. The equity of the proprietors, moreover, may be only a fraction of the corporation's total assets or liabilities.

Individuals are the only final owners of property and their net property rights may be negligible relative to that to which they have legal, more or less directly encumbered, title. Obviously it is his net rather than his gross credit, or debt, position which is significant to the individual. To a (closed) community, however, even the net position has no necessary importance or, indeed, any meaning. Total debts and credits, including those of corporations as well as individuals, must cancel out, leaving no net one way or the other.

<sup>1</sup> What is said in this section has reference only to the size, and not to the distribution, of the total volume of credit-debt.

The gross debt of the members of a (closed) community will be largely dependent upon current financial practices and has no necessary bearing on the community's general economic condition. The simplest situation is one in which all business is carried on upon a cash basis and there is no (formal) debt or credit. While this is simple it is not convenient, and debt-credit of some sort is therefore present in all civilized societies. It is a habit of debt to proliferate but, even when this proliferation takes flamboyant forms, it does not, in itself, do any particular harm. In the gross debt-credit of a modern industrial society there is much debt that is more apparent than real. If, for instance, an enterpriser decides to incorporate his business he may issue stock practically all of which he holds in his own possession. No real change has occurred in the situation but the gross debt of the community has been increased by the amount of the stock issue. A great deal of the increase in debt shown in past decades is nothing more nor less than the result of the incorporation of businesses which had hitherto been run by the owners as individuals.

The appearance, on organized markets, of many kinds of debt-credit instruments has also operated to increase the gross debt of the community without necessarily affecting in very marked degree the net debt, or credit, position of individuals. A man may not improbably mortgage his own home and, at the same time, hold to an equal value some sort of mortgage on another building.<sup>2</sup> His net debt-credit position is the same as if he owned his home unencumbered, and had not acquired the mortgage on the other building, but the gross debt of the community will be increased by the amount of both the mortgages. Similarly a well-to-do farmer may buy land on mortgage, rather than acquire it unencumbered, and, with the money which he might otherwise have put into land, buy the stock of industrial concerns. This will be merely to follow the prudent counsel against putting all one's investment eggs in the same basket. Assuming, however, that the land, the mortgage, and the securities yield equally well on their value at the date of acquisition, the farmer is no better or worse off than he would have been if he had followed the alternative of buying the land out-

<sup>2</sup> This may not be a merely futile duplication of instruments, even if both mortgages bear the same rate of interest, since questions of liquidity, or vendibility, may be the determining factor.



right; and the mortgagee is no better or worse off than he would have been if, instead of buying the mortgage, he had purchased the securities that actually went into the farmer's portfolio. Nor is anyone else affected. The gross debt of the community, however, will have been increased in the former as compared with the latter case.

The network of debt is a reflection of the degree of specialization of function in the community. The distribution of income over time is done by saving. Saving and investment were formerly done by the same person in the form of the acquisition of durable goods, including hard money. Individual saving is now, however, typically carried out by the acquisition of claims against someone else. Nor is this the end of the matter. The savings bank depositor, or the purchaser of insurance, buys claims against the savings bank or insurance company and these companies in turn purchase claims on third parties who, in all probability, hold further claims on other individuals and institutions, and so on more or less indefinitely. Even our money (including commercial bank demand deposits) is now almost entirely a debt of government or of private banking institutions, "secured," in the latter case, by the debts of borrowers either in the form of personal loans or some type of bond.

The outcome of the comprehensive trading in debts which marks a modern business community is largely, therefore, to have made the representative member of the community a simultaneous debtor and creditor, without any necessary change in his net worth, and to have greatly increased the gross debt of the community without any consequent change in its wealth or even in the distribution of that wealth among its members. Whatever the volume or character of debt, it does not, as such, alter the community wealth. Debts, and credits, can be indefinitely multiplied and might reach huge figures without any *necessary* disturbance to the economy. Gross pecuniary social income would be increased by a large interest item but net social income would be unaffected.

#### LIQUID CLAIMS AS A RATIO TO WEALTH

Though the volume of debt is not, in itself, a reflection of the state of the economy, a growth of debt may nevertheless make the economy very vulnerable to sudden shifts in the general appraisal

of business prospects. This matter has been well expounded in the book of A. A. Berle and V. J. Pederson on *Liquid Claims and National Wealth*.<sup>3</sup> The authors of that book show that, in the decade of the '20's, there was an enormous acceleration of a long-time trend in the growth of the ratio of liquid claims to total national wealth. These claims were largely in the form of debt and were held against goods most of which were not liquid in the natural sense of having a ready market in the process of moving, in response to a steadily recurring demand, from the point of production to an early and final consumption. An artificial liquidity, or at least shiftability, had been provided for naturally illiquid goods in the development of a variety of financial institutions to deal in debts based thereon. The sharp shift in the appraisal of business prospects, which occurred in 1929, precipitated a general attempt to cash in on such claims and this had devastating consequences.<sup>4</sup> The wider the network of claims against illiquid property the greater, of course, is the shock of a general desire to liquidate.

Berle and Pederson appear to believe that the solution of the difficulty lies in a sharp reversal of the trend in the ratio of liquid claims to the volume of underlying property. But this growth, as they themselves point out, arose from a general desire to obtain mobility, in the freedom from the restraint associated with non-fungible property. This freedom had long been sought, and attained, by a limited privileged class. Its expansion is, on principle, to be welcomed. "In any civilization worthy of the name, this driving desire to achieve a blank claim on anything capable of being purchased is almost a constant in the scheme of things."<sup>5</sup> Instead of attempting to deny the satisfaction of this desire the better policy is to sate it.<sup>6</sup> The thirst for liquidity grows inordinately when

<sup>3</sup> The Macmillan Company, New York, 1934.

<sup>4</sup> Many of the claims were not formal debts but equities in illiquid property. The results were, however, the same. The essential feature was the holding of an ostensibly liquid, or shiftable, claim against an underlying illiquid asset or merely potential earnings.

<sup>5</sup> Berle and Pederson, *op. cit.*, p. 4.

<sup>6</sup> The first sentence of the book just cited states that liquidity is probably one of the oldest phenomena in the economics of human desire; the authors then go on to say (p. 4) that the desire for liquidity has set up an economics so fragile that a detached student wonders that it can survive at all; and they reach the conclusion (p. 12) that an economic system based on liquidity *must* be thus fragile, *unless some device can be found to coin the national wealth into money at any time*

assuagement is withheld, but the mere offer of unlimited liquidity is frequently sufficient to remove the desire whenever a very modest fulfillment of it has been attained.

With money freely available, at a fixed cost in designated goods, the holders of such goods could have all the liquidity they want. The liquidity thus given would in all probability be quickly spread over the whole community and the thirst for it would disappear. In any event the progressive turning of goods into money must eventually sate the demand. To assure rapid appeasement of that demand it would perhaps be desirable to put a floor under the prices of securities, as well as commodities, through an earlier and wider application of procedures (for which there is now ample precedent) in the governmental support of the financial structure in time of storm. The money for such support, at prices for the securities on the low side of a "reasonable" figure, could be created for the purpose without danger of inflation since it would be withdrawn in the resale of the securities as soon as their prices started to pick up. There is no danger of inflation when the public is eager to get, and hold, money.

If reality is thus given to the assumption that liquidity, or shiftability, is present, the ratio of liquid claims to any tolerably accurate appraisal of the value of illiquid property will, perhaps, not be an occasion for much concern.

#### DISTRIBUTION OF DEBT IMPORTANT

The *distribution* of debt among individuals is, however, quite another matter. It is clear that the net transfer of title to existing

*when a tide of emotion, either of fear or desire, impels many owners to call for their supposed blank claims on civilization. (Italics mine.)* They appear to despair of any such device and it is, of course, impossible to make *all* wealth liquid. This, however, is not necessary. The desire to make wealth, in general, liquid, would never appear if a means were provided to the enterpriser, through the output of goods, to obtain liquidity in any desired degree. This is the purpose of commodity reserve money.

There have been many schemes to remove the function of money as a bearer of options, by putting some sort of tax on holding money, but they all run afoul of the strong and ancient desire for a varying amount of liquidity on which Berle and Pederson themselves lay emphasis, and would deprive men entirely of one of the freedoms they have persistently sought, viz., the disposal of their income as suits them best. If one *must* buy goods *immediately* he will be forced to take what he does not want rather than wait for what he does. Among other things, this would lead to a great deal of foolish investment. •

goods cannot, at any moment, exceed the amount of present goods available, but such transfers can be cumulative and it might readily happen that the gross volume of debt (credit) should become indefinitely greater than the aggregate present wealth of the economy. It is at once clear that, if the interest charges on claims held by those who are net creditors should exceed the total income of the net debtors, interest could not be paid in full and much of the debt structure would, with violent repercussions, collapse. There is always a tendency for some more or less remote approximation to this to happen. The piling up of debt seldom, if ever, goes as far as has just been assumed, but this is only because the collapse occurs, and the debt is wiped out, before the impasse has become logically complete. The thrifty members of a community are subject to constant importunity from the more or less improvident, many of whom, for a loan, are ready to mortgage the only asset they possess—their future earning power. As Adam Smith long ago pointed out, the majority of men have a quite irrational belief in their own luck and are inclined to view their future with much more optimism than the event will justify. They may, too, be lacking in the moral strength to accept a harsh situation if its exigencies can in any way be postponed. The thrifty, on their side, frequently overreach themselves and, with foresight by no means equal to their thrift (or perhaps one should say greed), yield to the importunities of dubiously competent borrowers and even press loans upon them.

Throughout history these traits in borrowers and lenders have been a fertile source of evil. Debtors have persistently put themselves in thrall to creditors, without any violence or deceit having been used to this end, and social action has been necessary to free them. The ancient Hebrews are alleged to have relieved the pressure on debtors by the sabbatical remission of their obligations; the reforms of Solon in Athens are said to have included a cancellation of all debts public and private; and the burden of pecuniary debts has often been alleviated in later times through a secular inflationary process (with occasional temporary reversals) which reduced the real value of the accounting unit either by debase-ment of the coinage or by an arbitrary increase in the supply of a "fiduciary" money.

Whenever the value of the accounting unit has, by accident or design, remained stable over any considerable period and, *a fortiori*, whenever its value has risen, the difficulties issuing from debt have grown appreciably, or fast, and some means of escape has perforce been devised. These expedients have been more urgent where mobility was not present—that is, where men were more or less closely tied to land and the land was saddled with a debt from which the serfs could not escape. The Roman law to which reference was made in the preceding chapter was modified to permit an heir to refuse any inheritance that was a liability rather than an asset but, in spite of repeated and varied attempts in later Roman times to alleviate the burden of debt, the Empire is supposed to have fallen because the debt-laden *honestiores* welcomed the barbarians whose advent gave them release from obligations they could no longer support.

The Christian Church went so far as to ban interest on debt but, because its precepts were more honored in the breach than in the observance, debt grew. The repudiation of debt, in one form or another, was, by reasoning similar to that which supported the prohibition of interest, regarded as nothing more than a venial sin at worst. It was only the more powerful debtors, however, who found it easy to escape.

Most legal codes, and this is particularly true of English law, show a progressive relaxation of the penalties on debtors in default, and there have been repeated instances of general legislation in practically all states, coming right down to the present time, under which whole classes of debtors have been relieved of at least a part of their obligations.

The fact is that something more than a strictly construed justice is essential to prevent the eventual invasion of the freedom of debtors under contracts to which no objection could well be taken at the time they were made. This is the occasion for bankruptcy laws and for the protection of certain types of property against seizure for debt. A workman's tools, for instance, were early made immune to seizure so that he would not be prevented from earning in consequence of his entry into unfortunate commitments in the past. The extension of the scope of such laws as time goes on may, with some confidence, be expected.<sup>7</sup>

<sup>7</sup> This is but one aspect of the treatment of failure in general. With the fullest

The holding of debt by net creditors can, at a maximum, exceed the total value of the durable property of the community only so far as the debt represents claims against the future labor income of the debtors. A certain amount of such debt is legitimate, and even salutary, but it has a tendency to get out of hand. There are thousands of people in a modern community who have so mortgaged their futures as to have committed themselves to virtual slavery. Some limitation on the ability of lenders to establish prior claims against an already heavily mortgaged borrower's income is, therefore, to be desired.

#### MATHEMATICS OF DEBT AND INTEREST

If we look at the volume of pecuniary savings in the United States in any normal year, under the knowledge that the bulk of this saving is done by relatively few individuals, it is clear that the investment of these savings to earn the expected rates of interest must be accompanied by heavy losses and that, if a large part of this investment is in the form of fixed monetary obligations, repudiation, by one means or another, of much of the debt is inevitable. Otherwise the accumulation of obligations would, in a not very lengthy period, reach a sum on which it would be intolerable for debtors to pay the stipulated interest out of any income, *in accounting units of fixed value*, which there is the slightest reason to hope will accrue to them. This is true even if the investment is not compounded by ploughing in the interest. If provision is to be made for the latter process, the invested sums, if they could be kept intact, would attain to astronomic heights. If a sum of \$8,000,000,000 (the rough average value of net capital formation in the United States for the period 1919 to 1930)<sup>8</sup> could be safely invested each year at 4 per cent, together with the interest compounded annually at that figure, the total would, in the course of a century, amount to approximately ten trillion dollars, and the interest on it to \$400,000,000,000. The aggregate national *wealth*,

equality of opportunity some members of the community will be unable to pull their weight in the social boat. The method of dealing with such cases gives room for much difference of opinion. About all that can be said is that it should be as gentle as is consistent with a progressive reduction in the number of the failures.

<sup>8</sup> cf. Simon Kuznets, *National Income and Capital Formation 1919-1935* (National Bureau of Economic Research, New York, 1937), Table 13, category iv, 1, p. 48.

including real estate (to say nothing of annual income, which has not yet reached \$100,000,000,000) has never been above \$370,000,000,000 and is now estimated to be very considerably below that figure. Fixed assets, other than real estate, reached their current maximum in 1929 at \$114,000,000,000.<sup>9</sup> It is, of course, unreal to compound savings unless it could be supposed that no investor would spend his interest receipts on consumption and that there would be no decumulation of capital.<sup>10</sup> With any such accumulation as is above imagined the interest rate would, moreover, soon fall to a negligible figure. It will suffice to assert, however, that, with monetary savings that are now not unusual, the hopes of investors for safety of principal, and receipt of a "satisfactory" rate of interest, are bound to be in large part disappointed.

Individual losses, as has been pointed out, are a normal, inevitable, and socially salutary phase of enterprisership and, to prevent repudiation of contract on a quite disruptive scale, it is therefore desirable that property should be engaged in the form of equities rather than in securities of fixed nominal value and fixed interest. The relative growth of the latter type of investment, by restricting the number of immediate risk-bearers, has so concentrated the immediate burden of losses as greatly to have reduced the incentive to enterprise. It has, moreover, probably multiplied bankruptcies in the endeavor of enterprisers to escape from an unbearable load of fixed debt. Where release has not in this way been widely obtained, a rickety general business structure has been shored up by new extensions of credit-debt, until the only alternative has been monetary inflation or a credit collapse of major dimensions. The search for an impossible security has thus defeated its own ends and the gilt-edge on many bonds has been replaced by a broad band of mourning.

A strong effort should therefore be made to hold engagements in fixed amounts of money to a minimum. There are cases in which such are the only appropriate obligations but the use of bonds, rather than equities, as a method of business finance has been dis-

<sup>9</sup> cf. Berle and Pederson, *op. cit.*, pp. 109-111. These figures, of course, mean little unless it could be assumed that the dollar had a stable real value. The national income will presently, no doubt, exceed one hundred billion dollars but this is partly because the dollar is currently declining in real value.

<sup>10</sup> The fact probably is that a part—how great a part is uncertain—of the interest receipts on old investments is annually reinvested. .

astrously overdone. Not only should the amount but also the term of bonded obligations be restricted. The issue of business securities, of fixed nominal value and fixed interest, with terms up to 100 years is, on its face, ridiculous. In a world of constantly changing technology and demand there is no type of business that can presume to count for more than a very limited period—say, at a maximum, twenty years—on the stability of conditions which fixed obligations imply.<sup>11</sup> Amortization of any given issue, within that period, should be a requisite of the contract. Change is inevitable and fluidity essential to meet it. A fixed debt, however, binds the debtor against the adjustments essential to successful dealing with a constantly changing situation. The greater the volume, and duration, of fixed debt by much more than proportionately is it certain to become an incubus.

#### DEBT, DEFLATION, AND INFLATION

The pressure of debt upon the debtors is enormously and egregiously increased, and the collapse of the debt-credit and business structure is precipitated, by a rise in the value of the accounting unit. Deflation must, at all events therefore, be prevented. Deflation, however, is a danger which is probably passing. The secular bias toward inflation has been greatly strengthened, in modern times, by the universal use of debt money and, in the absence of a resolute procedure for stabilization of the value of the accounting unit, inflation will almost certainly proceed with fewer checks, and temporary reversals, than it has had in the past. No government is likely in the future to permit any marked deflation when the means to avert it, in the issue of debt-money, are in its own hands. The menace, therefore, is all in the contrary direction.

Inflation does, of course, relieve the debtor (at the expense of the creditor) and, since the creditor can be mulcted with less serious social results than accompany the mulcting of the debtor, it is to be preferred to severe deflation as the lesser of two evils. But a more or less persistent inflation, if precisely predictable, would be attended by an upward adjustment of interest charges and would, therefore, in the long run give no relief to the debtor, while, if the pace of a more or less certain inflation were not (presump-

<sup>11</sup> Conversion operations may offer a loophole but these are usually available only to concerns in relatively little need of them.



tively) predictable, the whole basis for debt-credit would be removed and society would return to an ineffective hand-to-mouth method of production. The inevitable losses of savings must occur in some way other than this if a reasonably satisfactory economic structure is to be established and economic power is to be developed and distributed in optimum fashion.

The appropriate procedure is to put losses upon those who are willing to assume them, as a condition of the opportunity for special gains, without loading such persons with a wholly unnecessary burden from which they are eventually bound to seek an escape at the expense of those who had attempted to attain an impossible, and therefore illusory, security. A steady sprinkle of failures is normal economic weather and, if postponed, will result in devastating deluge. "The economic slavery of debt can be avoided by the individual, the corporation, or the government only if it [*sic*] borrows merely on short terms, if at all, and merely so much as it is reasonably certain of being able to repay . . . [since] long-term debts tend to cause maladjustment and hence insecurity. . . . A healthier social condition will result when the owners of capital all directly share the risks to capital which are inherent in an ever changing economic world. [The] assumption of capital risks by those who furnish the capital will lessen the severity of those risks. . . . Funds commonly are invested in debt instruments for the sake of obtaining security, but the greater the investments of that type, the less is the security attainable."<sup>12</sup> In other words the economic and the legal title to property should be held by the same individuals and investments should, so far as possible, be put on an equity basis. This would be a safeguard against general economic collapse, or other exploitation of the thrifty, whose thrift, while necessary, is prone to overreach itself.

#### GOVERNMENT DEBT

Government debt is assuming an ever-increasing role in the financial arrangements of modern communities. An internal government debt is an obligation of all of the citizens, in their collective capacity, toward part of them as creditors. The latter, rather

<sup>12</sup> Melvin T. Copeland, "The Social Significance of Debt," Essay contributed to *Explorations in Economics* (Notes and Essays in honor of F. W. Taussig), (McGraw-Hill Book Company, New York, 1936), p. 506.

paradoxically, are included among the debtors. The rise in governmental debt is on all fours with debt-credit in general and, apart from distribution, has therefore no special significance. It is not inconceivable that the incidence of taxes to service, or perchance to extinguish, the debt would correspond with the receipt of interest on the government securities. If this should be the case and if, as is of course highly improbable, there had been no transfers of government debt from the hands of the original holders, the economic position of all the citizens would be precisely the same as if there had been no government debt at all. The debt could be wiped out, along with the taxes for its service, without any loss or gain to anybody.<sup>13</sup> Government debt is peculiar, also, in that the obligation on it can be more or less arbitrarily shifted from one set of persons to another through a shift in tax measures or their incidence. Whatever may have been the original distribution of the benefits and burdens of the credit-debt, it can therefore be altered in any degree at the will of the legislature.

There is no limit on the growth of governmental debt beyond which it could be held that the community would be involved in *necessary* difficulties either with respect to the amount or the distribution of the claims. All that is involved in interest on the debt, or its repayment, is a transfer, not an absorption, of wealth and income. Gross, as contrasted with net, pecuniary income is in-

<sup>13</sup> Let us suppose that a given amount is to be raised for governmental purposes and the decision is made to raise half of the amount by taxes and half by borrowing. The citizen must forgo immediate consumption on his subscription to bonds precisely as would be necessary in his payment of taxes. Suppose further that taxes and the subscription to bonds fall equally on all citizens in proportion to income. At the end of a year, interest will be due on the bonds and new taxation will be necessary to meet it. If the new taxes are levied, as the old, in proportion to income (which, we shall assume, is unchanged), every citizen will be called upon to pay in extra taxes exactly the amount he receives as interest on his holdings of bonds. In every subsequent year the situation will be repeated. Not a dollar, therefore, will be saved, or gained, by anyone as the result of the original decision to raise half the required amount by borrowing rather than all by taxation. The conclusion must be that borrowing rather than taxation can have no effect other than to obscure the real situation and, insofar as taxation is inequitable, to conceal any injustice involved in an evasion, by subscribers to bonds, of their appropriate share of future taxation, with the saddling of unwarranted, compensatory, taxes on others.

The abandonment of borrowing, and the meeting of all governmental expenses by taxation, would always produce a net social gain in the elimination of the cost of administration of a large public debt but this is a minor modification, merely, of the general principle above laid down.

creased by the transfer. But this is far from saying that the growth of public debt is, in fact, a matter of indifference or benefit to the community. As the debt grows in size, the taxation for its service, even though it involves merely a transfer rather than a net absorption of income (and not necessarily even a transfer if taxation and payments on the debt are closely correlated), nevertheless provokes increasing resistance.<sup>14</sup> Since the debt of a sovereign government is, in modern times, seldom repudiated outright, resort is then had to inflation.

If, moreover, inflation is avoided, the number of people in the community with a guaranteed real return on their investment grows, relatively to those without such a guaranteed return, whenever government debt grows relatively to total wealth and income. This, as noted above, increases the hazards of all holders of equities who will, in one way and another, be taxed to meet the government debt. The greater the proportion of the social return that is fixed in volume, and assigned to certain individuals, the greater the concentration on the remainder of any vicissitudes that may occur. The increasing hazard to enterprisers enhances the reluctance to initiate enterprise, and the function of the enterpriser, in consequence, gravitates toward the government. Any losses incurred in the government's operations are then "socialized," that is, they are visited indiscriminately on those who would otherwise, for a consideration, have voluntarily assumed them and on those who would not.

Aside from minor smoothing operations there would seem to be slight, if any, justification for interest-bearing governmental debt and no reason, at any time, to abandon the pay-as-you-go policy as a general principle. Exception might be made for the acquisition of capital of a commercially productive character in any industrial or commercial enterprises the government might feel impelled to undertake. But all other expenditures might better be covered by taxation than by borrowing. There is much loose talk about casting the burden on the future through the borrowing process. A (closed) community, as a whole, cannot in this way cast any

<sup>14</sup> The current economic position may be unchanged but there is likely to be an alteration in the psychology of the community which may have subsequent adverse economic repercussions.

burden on the future.<sup>15</sup> If it were possible to do so it would be silly to assume any burden in the present since, when the former future becomes the present, the process of postponing the burden could be repeated and so *ad infinitum*. All that borrowing can really do is to change the incidence of the present burden and that of future incomes. It is true, of course, that, if lenders will part with present resources in exchange for claims on the prospective future income of the borrower and, when the interest and principal on these fall due, will turn them in for an agio in still more distant claims, the borrower need never undergo any sacrifice. But the lender will, in effect, then be giving his resources away and, so far as consumptive enjoyment of them is concerned, might as well have had them taxed away in the first place.

Taxes can, moreover, be so arranged as to give the same result, on future incomes, as loans not re-lent would do. This would happen if the payer of heavy taxes in the present should receive a remission of part of his taxes in the future. By thus compounding for otherwise heavier future taxes, for the remainder of his prospective life, he would be just as well off as if he were to receive interest on a loan and later pay taxes unremitted in any degree.

Nothing, in brief, that can be accomplished by government debt is impossible of attainment through appropriately distributed taxes. The circumstances of government borrowing and spending are quite different from those to which the individual is subject. Governmental spending is seldom for the acquisition of durable property yielding an income that accrues, in the first place, to the borrower and is therefore capable of carrying the debt. The state goes through no cycle comparable to the adolescence, maturity, and senescence of the individual. It cannot be said to have a fixed disposition toward active adventure or passive thrift. Interest and principal on long-term government debt must be paid out of a stream of income which does not normally accrue either from investment of the funds in durable capital goods or to the group that did the borrowing. The taxpayers and the buyers of government securities are not mutually exclusive groups and it is therefore gravely misleading to assert that the taxpayers cannot afford the "heavy drain" of a given governmental expenditure. Few, if

<sup>15</sup> This is true with the (relatively minor) exception that it is always possible to use up part of the physical capital in a society, and postpone replacement.

any, of the considerations which warrant private debt therefore apply to any public debt, with the possible exception of that incurred for expenditure on durable business property, and this should be amortized *pari passu* with the deterioration of the property.

The expenditures of all governmental authorities except the central government do not, as a rule, vary greatly and there is, in consequence, but slight reason for borrowing to meet any part of them. The upshot of any such process is a steady growth in debt and the increase, by the amount of payments for interest, of the sum of taxes that must be levied year in and year out. It would seem but the part of common sense to lay adequate taxes in the first place and avoid persistently increased levies to provide service on the debt in perpetuity.

The great expansions of expenditure by central governments occur in connection with war and with general unemployment. In war, the essential thing is to divert to government as much of what would otherwise be private income as is consistent with the maintenance of productivity. If the exigency is extreme, all private income, above what is necessary for the preservation of productive powers, should be taken. Part of the population is called upon to make the supreme sacrifice of life itself. It is a travesty on equity not to take in taxation, on those who do not risk their lives, the full sums required for the prosecution of the war. So far as such sums are merely borrowed, those who have fought and survived the war are later called upon to contribute from their earnings to those who sat it out.

To deal with unemployment no net governmental expenditures should ever be required. The cure for unemployment is work and, with work, the formerly unemployed will carry themselves. Under the proposals made in Chapter V, interest-bearing government debt need never be issued, on any extensive scale at least, in treating the phenomenon of unemployment.

In view of the institutions that have grown up around a large public debt, a rapid reduction in its volume would no doubt be seriously disruptive, could legislatures summon the courage to attempt it. But every effort should be made to prevent any increase in the already menacing total. The complacency, and even favor, with which the growth in public debt has, in many more or less

responsible quarters, been received, is surely unwarranted.<sup>16</sup> Pecuniary expenditures, it is true, are the sole source of pecuniary income but it by no means follows that any expenditure is as good as any other. It behooves us to watch not only what our expenditures are for but the long-run distribution of the costs.

#### DEBT AND THE TAXATION OF INHERITANCES

The wider the distribution of savings the less the difficulty with respect to either private or public debt. One of the effects of limitation of inheritance would no doubt be a more equal distribution of saving. The possible reduction in the total savings might then simply diminish the volume of losses thereof. The urgency of the need for savings is, in any case, reduced as the rate of growth of population declines. The size of the capital structure can then reach a state of relative stabilization without any great, or probable, deleterious effects.<sup>17</sup>

Private debt claims, other than those which are based on durable property, die with the debtor.<sup>18</sup> These claims have as their sole support the future income of the borrower and, when the possibility of this is gone, must properly lapse. They cannot, without inequity, be transferred to another living person or to persons yet unborn. The whole trend of civilized law has been in the direction of relief of the latter groups from the uncompensated debts of their forebears. The debts of impersonal, presump-

<sup>16</sup> Continuous deficit financing as a stimulus to the economy is reckless in the extreme and a confession of mental insolvency. It has been partially justified, however, by the intellectual bankruptcy of most "conservatives" who, in the face of breakdown, could find nothing better to do than indulge in a wringing of hands. Their complaints, though not their general attitude, were nevertheless warranted since debt, and inflation, are diseases to which democracies are peculiarly susceptible. They offer a (temporarily) easy way out of straitened circumstances, and the voluntary assumption, by the population at large, of foresighted hardship requires an unusually high level of (financial) morality.

<sup>17</sup> In spite of much reputable opinion to the contrary it is not at all clear that progress could not be maintained without any net new saving whatever. New inventions frequently reduce, rather than increase, the need for capital. The *necessity* for new investment can be cogently argued only on the assumption of a rigid propensity to consume. Such rigidity as there is probably arises largely from the existing distribution of wealth which might be greatly altered by heavy taxation of inheritances.

<sup>18</sup> The creditor can usually be protected against loss, from the unexpected death of a personal debtor, through an assignment of insurance on the debtor's life.

tively immortal, borrowers complicate the matter. So far as business corporations with limited liability are concerned, however, their debts can be worth no more than their current assets or the capitalized value of their present and prospective profits. When this becomes zero, or the assets are seized for debt, the debts are extinguished. But government debt, unless paid off, is never reduced. Central governments, in modern times at least, seldom make a *declaration* of bankruptcy. Government debt is thus subject to a permanent cumulative tendency from which other debts are, in a measure, free.<sup>19</sup>

Repudiation of these debts, other than by formal bankruptcy, is ultimately certain if they continue to increase. This means inflation. Since government debt, in any case, has little to commend it, it should almost never be allowed to grow. Special encouragement, with a view to the retirement of the debt now outstanding, might be given to the payment of inheritance taxes in the government's obligations.

The drastic taxation of inheritances proposed in the preceding chapter would, directly or indirectly, transfer to the state many debt claims, including those against itself. It might be supposed that the presence of impersonal, presumptively immortal, holders of the state or other debts would prevent a large part of these debt claims from coming under inheritance laws. The ownership of most legal persons lies, however, with natural persons, and the share of each of the latter in the debt holdings of legal persons would be attached on his death. The same is, of course, true of commodity assets. Neither the commodity assets as such, nor the volume of instruments of debt, would be disturbed by the transfer of their equivalent in value to the state. They would simply be sold to new holders by the admin-

<sup>19</sup> It is here a matter of concern that, when certain private corporations get into difficulties but are so important in the economy that it is felt that they cannot be allowed to sink, governments take over their debts. Similarly, with any business enterprise that government may undertake, there is a tendency for debts to pile up indefinitely whenever the enterprise ceases to be profitable.

It is the part of wisdom to leave business, as far as is consistent with the maintenance of freedom, in the hands of private enterprisers; to keep business units to such a size as will make their failure, if it occurs, not socially disastrous; and to suffer them to fail, to the exclusive loss of their private owners who voluntarily take this risk, whenever they cease to correspond with economic requirements.

istrator of the decedent's estate who would turn over the proceeds to the government.

A considerable amount of property, however, is held by self-perpetuating groups of trustees, or other types of corporation, in which no individual has any evidence or even color of ownership. The property of such corporations would never be subject to inheritance taxation, and there might be a tendency for such corporations to accumulate an ever-growing volume of debt claims and an ever larger proportion of total social income. Since these corporations are, for the most part, at least allegedly eleemosynary, this might go on for some time without serious social inconvenience though, as earlier suggested, it might eventually be necessary to bring into effect some new statutes of mortmain. Fluidity in claims to property and income, here as elsewhere, is indispensable to the development of power, to freedom, and to equality of opportunity.



## CHAPTER VIII

### WAGES

IN the chapters on the *production* of income the importance of the relation between contractually determined shares of income and the residual was emphasized. It was there made clear that prospective maldistribution of income may be decisive in preventing its formation but, aside from this, it is of significance in and of itself. The recipients of each of the shares has an obvious interest in getting as much as is consistent with the maintenance of production. If the receivers of contractual incomes attempt to get more than this, production will stop and all parties will suffer: if they fail to get as much, there is no *immediate* reason why production should not run at a high level; yet this might be of little benefit to anyone but the enterpriser and the favorable conjuncture is, in any case, not likely to last.

#### WAGES THE PRINCIPAL ELEMENT IN ENTERPRISERS' COSTS

The principal element in contractually fixed shares of income, and in enterprisers' costs, is wages. Any given concern may, of course, lay out more on materials than on labor but the cost of the materials is largely attributable to wages previously paid out and varies with them. Of the net income from private production in the United States, about two-thirds accrues as wages (including salaries) and there is a sizable additional element in total income which, as will presently appear, is really wages but is not reported as such.<sup>1</sup> Interest, rents, and royalties, taken together, make up, roughly, but 10 to 12 per cent of the total national income, so that wages are either directly, or as embodied in raw materials, many times as important as all other charges on enterprisers.<sup>2</sup> With a given level of prices and full employment, the possibility of profits to enterprisers as a group is therefore all but completely dependent upon the money wages paid per unit of output. For this reason the notion that an increase in employment in a state of depression

<sup>1</sup> It is also true that some income reported as wages is, in reality, something else—quasi-rent or profits.

<sup>2</sup> Temporary National Economic Committee, Monograph Number 4, *Concentration and Composition of Individual Incomes 1918-1937* (United States Government Printing Office, Washington, 1940), Table II, p. 38.

is conditional upon a reduction of wages is widespread. It is assumed that it *must* have been excessively high wages that caused the depression or, at any rate, that wages are currently too high to permit of a resumption of activity by enterprisers.

The prices received for commodities are, however, not independent of the wages paid out in the productive process and a cogent argument can be made for the contention that, as matters now stand, the height of money wages has no necessary bearing on economic activity and employment. In the heyday of the international gold standard the price level in any country was integrated with price levels abroad on the basis of fixed rates of exchange of the respective currencies against one another. The price level in any one country could not then rise above a certain relationship with price levels abroad without endangering what was regarded as the ark of the covenant, the Gold Standard itself. Whenever such a danger appeared, in an efflux of gold, measures were taken to prevent any further rise in prices or to effect a fall. The deflationary pressure thus exerted brought on unemployment and this made it possible to drive down wages. There was thus a quasi-automatic limit on the height of money wages, per unit of output, and therefore on prices. There is now, however, no automatic check on price movements in any country, since adjustments to foreign price levels can readily occur through an alteration in the rates of exchange without the necessity for deflation. There is no longer, as under the international gold standard, a direct transfer of purchasing power from the country of relatively rising prices to countries where prices remain comparatively low, but merely an adjustment of the price of one currency in terms of another.<sup>3</sup>

Since increased money wages now mean an unimpaired increase of like amount in the flow of monetary purchasing power within the country, there is no reason why there might not be an accompanying and roughly proportionate rise in the prices of commodities. This would enable enterprisers to cover their increased wage bill and other costs without impairment of profits. Employment could then continue at a high level. On the other hand, with a

<sup>3</sup> The transfer of gold from foreign countries to the United States, or vice versa, does not affect the supply of money in the foreign countries since gold is no longer a factor in the money supply of most, if not all, of them. Nor, with the bloated reserves in this country during the past decade, does it have any appreciable effect on the supply, or flow, of circulating money in the United States.

lowering of money wages, in a depression, prices are likely to fall. There is in these circumstances no reason to assume any improvement in the general rate of profits, and the reduction of wages would thus prove to have been futile.

#### RELATION OF WAGES TO EMPLOYMENT

Whether or not a rise or fall in general money wages will affect employment depends not on the increase or decrease, as such, but on the reaction of enterprisers to it. If, with a rise in wages, enterprisers expect commodity prices to rise in more than proportionate degree, they may spend freely, for inventory or new equipment, from accumulated or newly created funds. The increased movement of money toward goods will stimulate employment. If, on the other hand, enterprisers do not expect much if any rise in prices as a consequence of increased wage payments, they may curtail expenditures with a consequent reduction in employment.

In both cases, the enterprisers' expectations with respect to prices would be fulfilled. Diverse results on employment may similarly follow a lowering of wages, according as enterprisers react to it in an optimistic or in a pessimistic way—that is, in expecting prices not to fall as much as, or to fall farther than, wages.

Most enterprisers, of course, feel much safer and more optimistic when they are able to reduce wage rates in their own establishments than when they are forced to increase them. If, whenever they succeed in reducing wages in their own plants, wages in other plants in their own industry, or in industry in general, are coincidentally maintained, and general purchasing power thereby kept up, an improvement in their own profit and loss account will probably occur. There is, therefore, rather more reason to expect entrepreneurial activity after a reduction than after an increase in the rate of wages in their plants, though the anticipations on which the enterpriser acts may be as warranted, or unwarranted, in the one case as in the other.

If, however, there is *general* hesitancy about expansion, as is likely to be the case in a situation in which wage rates can be forced down, prices will fall in correspondence with any reduction of wages; the opportunity for profit will be lost; employment will continue low and may even decline. With a more hopeful attitude, the very knowledge that increases in wage rates are spreading

may, on the other hand, stimulate purchase of equipment, or at least inventory, in anticipation of a rise in prices, may thus increase employment and, as the anticipated advance of prices occurs, do no harm to profits in general.

The two cases are illustrated by the failure of successive reductions in money wages to stimulate enterprise in the United States in the latter part of the 1929-1932 depression and by the sharp increase in employment which accompanied the advance in money wages with the introduction of the NRA in 1933. The experience might be alleged to prove that a lowering of wages is unfavorable, and that an increase in wages is favorable, to employment, but this would be an unwarranted inference. Cases could readily be cited on the other side. The fact is that, in a typical modern industrial plant, any given rate of wages may or may not be consistent with profits according as business becomes brisk or dull at prices which show no substantial change. This is true even if prices remain stable after wages have been increased. The general recognition of a "break-even point" may be advanced in evidence. If the volume of business is below the "break-even point," losses will, of course, be incurred; but profits will pile up rapidly, with unchanged prices and wages, or even with somewhat higher wages, in the degree in which the volume of business overtops the "point."

It may be concluded that the effect of changes in money wage rates, especially when, as now, the price level is indefinitely flexible in either direction, is independent of the direction of the change and is a function merely of the anticipations it provokes. There is no money wage in a closed economy, with a flexible price level, which would ever of itself lead to unemployment.

The case with regard to real wages (the relation of money wages to commodity prices) is not so clear. Professor A. C. Pigou has argued that, in the short run and in the absence of expected further cuts, a general reduction of real wage rates will tend to expand aggregate output and employment.<sup>4</sup> Similar views are held by many other economists. A modification of Pigou's position has been advanced by Mr. J. M. Keynes who asserts that money wage rates and real wage rates tend, with a change in aggregate output,

<sup>4</sup> A. C. Pigou, "Real and Money Wage Rates in Relation to Unemployment," *Economic Journal*, XLVII, September 1937, pp. 405-422.

to move in opposite directions and that while, in the short run, output and employment can be substantially increased by a general reduction in real wage rates, employment cannot be increased by a general reduction in money wage rates.<sup>5</sup> This means that employment can be increased only by raising prices with wages either stable or increased in lesser proportion than the increase in prices. Pigou, in contrast, had held that a general reduction in real wage rates, and increased employment, could be achieved by a general reduction in money wage rates with prices stable, or falling less than wages.<sup>6</sup>

The discussion is, perhaps, beside the point. If, as is certainly true of present monetary conditions, prices are not independent of money wage rates, there is no means of conscious adjustment of prices to wage rates, or vice versa, and therefore no sure way of adjusting real wages. When, with full employment of resources, prices for any reason fall, and money wages do not, real wages automatically rise and unemployment appears. A reduction of real wages is, in the absence of other stimuli, then essential to provoke any disposition toward enterprise. The only way that *enterprisers* can hope to bring this about, without exaggerating unemployment, is through a reduction in money wages but, unless this is accompanied by large outlays for goods which laborers do not buy, the enterprisers' hopes will be frustrated in the consequent fall in prices. Such outlays are most improbable in the circumstances since existing equipment is then only fractionally employed and it therefore seems folly to increase it.<sup>7</sup> The only solution of the dilemma is the support of prices, either directly through provision

<sup>5</sup> *The General Theory of Employment, Interest and Money* (Harcourt, Brace and Company, New York, 1936), pp. 10, 17-18.

<sup>6</sup> This matter is more fully treated in an excellent paper (soon, I hope, to be published) by one of my students, Mr. Randall Hinshaw.

<sup>7</sup> If it were true, as many economists allege, that the prices of investment goods vary inversely with the rate of interest, the disposition to buy equipment would be still further impaired since, in the situation described, interest rates would probably be low and the prices of investment goods presumptively high. It is unlikely, however, that this factor will be operative since the prices of reproducible investment goods will not usually deviate far from their costs of production, which will not have been increased. The coincidence of their market price with their presumptive yield, capitalized at prevailing low rates of interest, is achieved through a reduction in the anticipated yield rather than through a rise in their market price.

of a special demand for goods, or by the injection of so much new money, without a corresponding output of goods, as will more than compensate the reduction in the rate of flow of money in general. The latter process, if effective, is likely to be dangerous in the menace of inflation that it presents.

#### ORDERS MORE IMPORTANT THAN WAGES

The true governor, not only of profits but of the rate of production of a typical firm in a modern economy, is not the relation between money wages and some hypothetical price level presumptively determined independently of the producer. Rather is it the volume of orders, with prices which the producer himself sets at a height sufficient to cover his costs, that is the determining factor. Real wages, therefore, are, in the play of prices, automatically adjusted to permit profits to enterprisers, *if the enterprisers can get orders at their quoted figures*. No firm can afford to produce at a rate consistently in excess of the flow of orders for its product and it would be quite impossible for it to produce at a rate consistently below its rate of filled orders. Orders are, therefore, the *sine qua non* of modern productive activity and, if resolutely provided by public action, will operate to eliminate maladjustments which might otherwise prevent private orders from developing.<sup>8</sup> Adequate orders will not develop in the private economy, however, if quoted prices are unduly high; and they are, in the long run, of no value to enterprisers if they can be obtained only on quotations of prices that will not cover costs. With provision for an unlimited demand for goods (to fill in gaps arising from shifts in the preference for liquidity), and with provision also for stability in the price level, real wages should therefore be kept as high as, and no higher than, is compatible with a volume

<sup>8</sup> The whole explanation of depressions in terms of "structural maladjustments in the economy" is inane. Structural maladjustments are always present, are usually in process of elimination, and are constantly appearing in new forms. If production is kept going, the process of elimination of such maladjustments proceeds apace but, if they are permitted to stop production, the maladjustments are multiplied in a vicious circle of economic stagnation. Many economists have been content to discourse on structural maladjustments as if they were acts of God (rather than a result of defective human institutions) and to enlarge their importance in indefinitely proliferating structural fictions about frictions. The obvious remedy is so to alter the institutional environment as to preclude such structural maladjustments, as may occur, from becoming chronic.

of private orders adequate over time to take output off the market at prices which offer a prospect of profit to enterprisers.

#### IDEAL LEVEL OF REAL WAGES

The reasons for preventing what must at best be a temporary increase of wages above the level suggested in the preceding paragraph are sufficiently obvious but, both on grounds of equity and expediency, it is equally important that they be kept from falling below it. For this will temporarily so increase profits as to pile up savings more rapidly than they can readily be absorbed in productive investment and will reduce the normal demand for the type of consumers' goods currently being produced. This demand may be temporarily sustained by the extension of consumers' credits more or less directly out of the current excessive profits. Reduction of demand below the level of output may thus be postponed but, with excessive profits, it cannot be permanently averted since the process must come to an end whenever a preference for liquidity, for then very good reasons, makes its appearance.

As things now stand it is very difficult to prevent or even discover, except *ex post*, a deviation of real wages from their ideal level. Conditions would be very different, however, if the price level of a large group of commodities were fixed by the free convertibility of a composite of those commodities, both ways, with money. The maximum money wage compatible with full employment would then not be indeterminate, as is at present the case under flexible general price levels, but would be fixed, and recognizable, in the costs of marginal industries producing commodities included in the monetary reserve. Since production of the "reserve" commodities could always be expanded until no more labor was available, full employment, at the wage corresponding to productivity, would tend to develop. The play of competition, accompanying full employment, would, sooner or later, transmit to other industries the wage level in the bell-wether industries. So far as changes in productivity in the non-reserve industries (as a whole) did not keep step with those in the reserve industries (as a whole) the price level of the non-reserve commodities would then, as previously noted, tend to move downward or upward as relative productivity in the non-reserve commodity industries increased or diminished.

Real wages as a whole would rise or fall, therefore, according as (1) money wages went up or down with shifts in absolute productivity in the reserve industries, and (2) as the prices of non-reserve commodities, as a whole, receded or advanced. Real wages are, of course, inevitably conditioned by productivity, and the criterion of their maximum level, with an unlimited demand for a wide variety of commodities, would then be the volume of employment. If employment, under competitive conditions, were less than full and not rising in the reserve commodity industries, the only possible explanation would be that both real and money wages were too high.<sup>9</sup> There could be no argument about it and an appropriate reduction in money wages would clear up the difficulty.<sup>10</sup>

#### POSSIBILITY OF INCREASES IN WAGES OUT OF OTHER SHARES IN INCOME

Not only does a very large part of total output accrue to wage earners but all the records go to show that the *share* accruing to them is extraordinarily stable—that is to say, workers tend to receive about the same *proportion*, in good times and bad, of whatever income is produced.<sup>11</sup> Because wage workers already receive the bulk of income produced, any great increase in their real wages must come through an enlargement of per capita output. But it is nevertheless not clear that, with any given output, the workers might not obtain a substantial increase in their share without causing a stoppage of production.

The increased *share* of income going to wages must come from rent, interest, or profits. Reported rentals are, for the most part, interest payments on investments in buildings and these are not nearly so vulnerable to attack as pure rents (as that word is used in economic theory) would be. The share of total income paid in the form of rentals and interest is, moreover, in any case so small that any feasible transfer from these categories to that of wages would be of but slight importance to workers. The category of profits looks, and perhaps is, more promising. Yet much of the in-

<sup>9</sup> With a substantially stable price level there would, of course, be no difference between real and money wages.

<sup>10</sup> All the interminable dispute which now afflicts us as to whether wages are or are not excessive, and whether there is *any* wage which would provide full employment, would go by the board.

<sup>11</sup> cf. *Report of Temporary National Economic Committee, loc. cit.*



come included in entrepreneurial returns (either as direct entrepreneurial income or dividends) is, in fact though not in form, wages. The whole net income of farmers, for instance, is reported under the head of entrepreneurial receipts. There have, however, been few farmers in the United States in recent years who have got more from their activities than they could have obtained as workers in other industries, provided employment in those industries had been available to them. There is no doubt that farmers work their farms as well as manage them. Their returns, such as they have been, are therefore labor incomes rather than profits. Similarly the income of small shopkeepers (and that of other one-man or one-family enterprises), included in the statistics as entrepreneurial income, is in reality largely a wage return. In a country in which the great bulk of business activity is carried on by corporations, the true entrepreneurial income, if shown at all, must appear as dividends. These, as reported, hover around 6 to 7 per cent of total income and in this figure no account, of course, is taken of losses.<sup>12</sup> On the other hand, there is a sizable amount of entrepreneurial income which is now reported as wages and a further substantial lump of true entrepreneurial income which is "ploughed in" and does not appear in the returns. Excessive allowances may be made by business corporations for depreciation; reserves for various more or less remote contingencies may be set up; and new capital may be acquired out of profits. Most, if not all, of these returns are profits, not distributed to owners, and some invasion of them in the interest of wage workers might be feasible, especially with a greater degree of stability in the economy. The average rate of profits could, no doubt, be considerably lowered, without provoking unemployment, if enterprisers could count on a high continuous activity in business in general.<sup>13</sup>

On the whole, however, the conclusion holds that any considerable rise in the aggregate of real wages must be attained by increased productivity. The provision of an unlimited demand for a large number of products would not only increase productivity, through a reduction of unemployment to a minimum, but would

<sup>12</sup> *ibid.*

<sup>13</sup> A considerable share of the reserves now laid aside, by prudent managers, to cover losses in periods of depression, would emerge as profits if a substantial stability of business were attained.

permit of a large increase in output by drawing into truly productive activity many people now engaged on the periphery of the economic structure in a wasteful duplication of distributive facilities—the “invisible unemployed.” A reserve supply of unemployed or very partially employed labor is, of course, by no means unwelcome to enterprisers, since it permits a beating down of wages, but it is, for this very reason, essential to the worker’s interest that it be cleared up.

#### REDUCTION OF THE UNEMPLOYMENT ARISING FROM STRUCTURAL DISLOCATIONS

Some involuntary unemployment is, of course, inevitable. Seasonal trades are hard to dovetail, while changes in demand and the evolution of new methods of production are constantly shifting the requirements for given types of skill. This will, from time to time, result in a plethora of supply of one kind of labor though, with anything approximating full activity, a coincident shortage would appear in another. Changes in the location of industry also result in a maldistribution of labor, though the difficulty here is geographical rather than of a technological character. Many of the difficulties could be corrected if there were a paid reserve of versatile and mobile labor trained in several techniques, especially for newly developing jobs, and ready to go anywhere.

This reserve labor force need not be large since all that is required is a facile marginal adjustment of supply. Changes over the whole range of an industry seldom occur in other than a gradual manner. It is true that changes of fashion are sometimes complete, but technological changes are not introduced at a single stroke except in industries, if there are any, in which the whole supply is concentrated in one concern. Similarly, though the population of any small town may be left stranded by the elimination or removal of its principal or sole industry, the transfer of an industry from one *region* to another usually takes place at a temperate pace. An excess of any one type of labor supply is, moreover, automatically reduced by the voluntary retirement of older members, and by death, at a rate which would be adequate to compensate the bulk of reduction in the demand for any given grade of labor if haphazard replacements were inhibited. Where this is not so, a retraining and reallocation of workers is, of course, necessary.

Mobile and potentially versatile labor is to be found chiefly among adolescents just coming into their productive years and it is principally from this source that any shortage in the supply of any given type of labor must be overcome. There is now very inadequate provision for meeting such potential shortages since there is no guarantee to a private enterprise that it will not spend its money for training purposes only to see the trainee drawn off by a rival producer as soon as efficiency is attained. This is especially likely to happen where there is a concentration of competitive plants.

There seems to be no good reason why the provision of vocational training on a broad and effective scale should not be considered as much a public duty as the furnishing of any other kind of education. This would seem to be one of the functions of a reconstructed Civilian Conservation Corps. Much of the opposition to it would disappear if jobs were freely available rather than, as now, a sort of prescriptive privilege.

There are few jobs which cannot be mastered by reasonably competent workers in much less time than is ordinarily required of apprentices. The whole apprentice system is, in fact, little more than a device to reduce the supply of laborers in the occupation in question and preserve the semi-monopolistic position of the full-fledged members of the craft. It has a minor, if any, part in a system of free enterprise.

A labor reserve force, recruited not only from adolescents but also from the more mobile of mature workers temporarily displaced by technological changes, should be a normal feature of the economy.<sup>14</sup> The training of workers along lines of the developing demand for labor could do much to alleviate the inequities in the present system and eliminate wage and price maladjustments arising from coincident inelasticities in the changing demand and supply of goods. The public wants what it wants when it wants it, but on the one hand new production takes time and on the other old production is not readily shifted into new forms. The more readily the supply of labor can be brought into correspondence

<sup>14</sup> Workers displaced by technological changes, changes in fashion, and the like should, of course, be provided with dismissal compensation, or its equivalent, covering their normal expenses during the period of retraining.

with the evolving demand the less will society be plagued with the influence of such "structural maladjustments."

#### PROGRESSIVELY RISING MINIMUM WAGE

With steady employment at the fullest practicable level the strategic position of wage workers would be greatly strengthened and there would be a strong tendency toward the payment of as high real wages as could be afforded under given conditions of efficiency, hours of labor, and intensity of application. With the establishment of an unlimited demand for commodities, the test of whether workers were in fact receiving such wages would be the immediate prospect of unemployment in the reserve commodity industries on any increase in the wages paid.

But though, with full employment, the strategic position of workers, especially the unorganized, would be improved, it would probably not be equal to that of enterprisers. As general productivity increased, lags might be expected to develop in the advance of money wages to correspond with the improvement in the effectiveness of industry. Some provision should therefore be made to bolster the strategic position of the most weakly placed workers. This calls for a minimum wage law, with a schedule of periodic increases in the minimum in correspondence with advances in the computed secular upward trend in general productivity. Allowance might be made for any persistent rise or fall in the price level of non-reserve commodities that might occur. The appearance of unemployment, without any tendency to absorption of an enlarged number of workers in the production of commodities for the monetary reserve, would be irrefutable evidence that the rate of increase in the minimum wage was more rapid than the actual increase in productivity would permit. On the appearance of such unemployment, some flexibility in the application of the rule would therefore be necessary and the rate of increase should, temporarily at least, be reduced.

A steady upward pressure of wage rates on entrepreneurial net income is, however, desirable as a stimulus to managerial efficiency and, probably, as a means of reducing savings, relative to investment, through transferring a larger share of the total income to that sector of the population which saves a relatively minor pro-

portion of its income. Provided the pressure were not so great as to prevent the realization of positive general profits, this would be nothing but salutary, and a certain boldness in the schedule of advances in minimum wages is definitely desirable.

#### INCREASES IN THE HIGHER WAGES

A raising of the *minimum* wage in proportion to the increase in general productivity would, of course, absorb only a part of the savings made through improvements in the methods of production. Wages above the minimum level, and all other forms of income, could, in the aggregate, be expanded in similar degree.

There is far less likelihood, however, of any prolonged lag in the adjustment to increasing productivity of wages in the higher levels than in those at the bottom of the scale. The higher the wages the less subject are the recipients to exploitation of a condition of distress, and the easier it is to secure cohesion in collective action for raising remuneration.<sup>15</sup> The danger is rather that strategically situated higher-wage-level groups will be able to exact more rather than less than a proportionate share of any general advance in wages. The safeguard is to remove all artificial obstacles to entry into any craft. With this as one phase of a general effort to establish competition, the *distribution* of increases in wages might properly be left to take care of itself. There must, however, be no slackening in this effort.

Evidences of monopoly are no more lacking in the labor field than in that of the entrepreneur. Organizations of labor have risen in an all but inevitable response to the concentration of power in the hands of employers. Though they are a necessary and even desirable foil to that power, they might very readily get out of hand. The social attack on monopoly must be pursued without discrimination. The fact or ever-present probability of unemployment has, in the past, weakened the position of even the most strongly placed and organized crafts. Their absolute status would therefore, without doubt, be improved when unemployment had become a thing

<sup>15</sup> On the adoption, under NRA, of increased wages for the lowest-paid workers the wages of the better-paid workers presently rose more than proportionately. cf. Brief of the National Boot and Shoe Manufacturers Association at a hearing before the Administrator of the Wage and Hour Division, United States Department of Labor, Washington, Dec. 11, 1939.

of the past. But it would be necessary to guard against an unconscionable improvement in their *relative* status arising from the exploitation of a socially illegitimate strategic position at the expense of other workers and of the population as a whole.<sup>16</sup>

#### IMPORTANCE OF INCREASES AT THE BOTTOM

It is not only, in the interest of equity, of major importance to improve the strategic position of the worst-paid workers but this is the surest means of increasing social welfare as a whole. The recipients of the very largest incomes derive nothing from them but an enhancement of power which, after a certain point, is socially deleterious. The only socially legitimate advantage that the receiver of an income who is already making large savings gets out of an increase in his return is the capacity to save still more. If, moreover, we can place any reliance at all on the "law" of diminishing utility, the recipients even of incomes which, though below the highest level, are still large, obtain a good deal less satisfaction from each unit of income than do those in the lower ranges.

<sup>16</sup> So long as trade unions are not overweeningly strong aggregations of individuals, are designed to prevent the exploitation of members by powerful entrepreneurial units, and seek to assure nothing but an approximation to the conditions that would prevail under perfectly free competition, they serve the cause of freedom as a whole. Their function is then to face one aggregation of private power with another and secure a balance. It would be just as great a social disaster, however, if the unions were to secure a complete victory as it would be if their opponents should triumph. So long as the exigencies of technology require large producing units as a condition of the realization of social productive power it is not feasible to diffuse power so widely as to prevent any possibility whatever of exploitation in the realm of economics. The balance between more or less inevitable counter-aggregations of power in the economic field must, therefore, be maintained by the social group, as a whole, in its role of political sovereign. Any use of the growing power of a trade union as a monopoly—that is, beyond the point at which the conditions of free competition are as nearly as possible approximated—is an approach to the practice of totalitarianism on the bolshevistic rather than the fascistic model. We have had numerous adumbrations of each of these in labor spies, in the private armies of strikebreakers enlisted by employers and the more or less violent mass picketing by strikers, and in the numerous other forms of terrorization practiced by both parties to the industrial conflict. All of these phenomena are, of course, socially illegitimate exertions of power and must be ruthlessly and impartially repressed by sovereign political authority if tyranny, of one or the other or both of the parties, over the populace as a whole, is to be forestalled. It should be steadily kept in mind that any aggregation of private power may at any time develop into a conspiracy against the republic.

Should a progressive stepping-up of minimum wages encroach in some degree on the larger incomes the result would, therefore, be far from deplorable. Not only the well-being but the character of the population as a whole seems rather more likely to be improved by this than by any other change in the economic sphere.

It is conceivable, of course, that rising minimum wage rates, which are a departure from "pure" competition, would so lower the relative demand for the worst-paid workers (who are presumably incapable of fitting themselves for better jobs) as to evoke an exclusive unemployment in this sector of the economy. The danger is probably small but, if the phenomenon should occur, it would seem to be sufficient to reduce the hours of labor and "spread the work" for this group. The rate of pay per day need not be reduced proportionately. A diminution in the total earnings of the workers affected would result, so that there would be no probability of attracting other workers to these jobs as an accompaniment of the increased real wage per hour. It would be regrettable that any workers should receive a total wage below that which would issue from a full day at the minimum rate but this would be but another special case of the more or less widespread phenomenon of failure and would call for treatment similar to that accorded to all those who are unable to meet the increasingly exacting demands of social life.

For fully capable workers the length of the normal working day might properly be left exclusively to the collective decision of the workers themselves. The choice would be made on the understanding that, regardless of the number of hours worked short of a norm which might, perhaps, be set in the vicinity of forty hours per week, the normal wage rates per hour would not vary.

The idea is now widespread among workers that the more the working week can be reduced the better it is for the wage-earning class. This doctrine, if true at all, has obvious limitations. It arose under conditions in which the demand for labor seemed to be limited and the social economic objective appeared to be to secure work rather than income. When, under provision for full employment and free competition, it becomes clear that tangible income, not only for the group as a whole but for each sector in it, is dependent upon the work accomplished, the pressure to "soldier" in

various forms will be relaxed and, with due regard to the requirements of given techniques, the workers may without qualms be left to fix the length of their own working day. Free choice in the taking of remunerative work, or leisure at the sacrifice of material reward, is an essential part of freedom in general.



## CHAPTER IX

### *RENT AND INTEREST AS SHARES IN INCOME AND THEIR RELATION TO PROFITS*

**W**AGES and, to a certain extent, profits are returns accruing to the suppliers of labor services in the productive process, whereas rent, interest, and a different part of a broadly construed category of profits are returns accruing to the suppliers of property.<sup>1</sup> So far as the property has been acquired by its supplier solely through work and abstinence the return on it is ethically correlative with the return for the direct provision of labor.

#### ANALOGY BETWEEN RENT AND INTEREST

In essence, rent and interest are but different facets of the same thing, rent being the absolute return on engaged property and interest that same return considered as a rate on the capital value of the property engaged. Any return on temporarily alienated property is normally designated interest provided it is paid in the same medium in which the property was lent, e.g. money, but is otherwise thought of as rent.

In a more technical sense, however, rent may be regarded as a differential return proportionate to variations in the economic quality (presumptive earning power) of pieces of property of the same general character. With fungible goods, such as money, there are no significant differences between one piece and another so that, under free competition at least, no differential returns on a given type of loans of this sort of property can arise.

Any piece of property which, because of its superior economic quality, yields a differential return as against similar but inferior pieces may be differentially capitalized at the going rate of interest on fungible property (primarily money). Its value is thus a function both of the value of its yield and of the current general rate of interest. Conversely, the yield is at a rate, on the computed

<sup>1</sup> The entrepreneurial function involves not only the assumption of risk but also management as a routine activity (for which the return is, conceptually, wages rather than profits) and, in typical cases, the task of promotion and operation of a "going concern." Contrariwise, some returns, which are ordinarily lumped as wages, rent, or interest, have in them a contingent element analogous to profits.

value of the property, identical with the rate of yield on fungible goods (money). That is to say, the yield conforms with the going rate of interest.

The notion of rent and interest as substantially identical is therefore quite compatible with that of rent as a differential and interest as a non-differential return. When the yield from any piece of property is compared with that from other pieces of property of similar physical characteristics, but of lower economic quality, a differential return will appear. But, when the properties are compared on a value basis, that is, when they are translated into terms of a common fungible, the differences in value will be proportionate to the differences in yield. The different yields, whether called rent or interest, will therefore be at the same rate on the respective values of the properties compared. Since values are the only significant economic quantities—physical characteristics being, *per se*, irrelevant to economics—rent and interest can be distinguished from one another no more significantly on the basis of the presence or absence of differentials than on the basis of designation of the return as an absolute sum or as a rate on the value of the capital good involved.

#### DISTINCTION BETWEEN RENT AND INTEREST ACCORDING TO SOURCE

A different attempt at a distinction between rent and interest is that which designates the yield from natural resources as rent and the yield from man-made instruments of production as interest. This is conceptually a fairly clean-cut difference even if, in practice, it is difficult to separate that part of the yield of any instrument of production which is attributable to natural resources from that which is attributable to "stored-up labor."<sup>2</sup> Though the separation of property into natural resources and the corporeal fruits of labor may thus be logically made, the question of its purpose immediately arises.

There can be no doubt that, in the minds of many people, the distinction is based on ethical considerations. To them, economic

<sup>2</sup> The yield on money loans might be paid out of what in this terminology would be rent, interest, or neither. The fact that it is always called interest merely shows the difference between the popular and technical meanings of many words in use in economics. Money is certainly property but, from the point of view of production, is amorphous property.

rent is, in a peculiar sense, unearned income. The ethical title to it, and to the property from which it flows, is in their view clouded. Adverse comment on this view has already been made and it is obvious that, when rent has been capitalized, any purchaser for value of natural resources has as clear an ethical claim to a rent-interest return thereon as he could have had to an equal rate of return on any other form of property. Innocent holders for value, without notice, are surely entitled to as much consideration in this field as in that of wrongfully converted negotiable instruments. The relative defect, if any, in the ethical title to property in natural resources, and to the income therefrom, must thus lie in the original rather than in any later acquisition of legal title. Private property in natural resources was, no doubt, in many cases originally acquired and legally confirmed through the exercise of economically illegitimate power—but so was private property in other things. There can be no valid presumption that the original title to other types of property was untainted. Even on this score, then, the ethical distinction between property in natural resources and in other things will not stand up under analysis.

The claim to any *increment* of value in a natural resource is, moreover, quite as good ethically as is the holder's claim to a similar increment of value on property of any other type. There is no sure way of determining whether the increment in value which may in time accrue on any piece of property is or is not attributable to meritorious enterprise on the part of the holder or does or does not compensate a risk of loss which others refused to take. Increments of value on natural resources may as probably arise from the energy of the holder as from luck. Social developments which increase the value of property in natural resources are not infrequently attributable to the work of the holders. Good luck plays its part but it is not confined to those who have legal title to natural resources. Returns attributable to luck, so far as they can be segregated, are fair game for the tax-gatherer but it is in most cases impossible to separate them from returns accruing from the exercise of truly economic powers, and they are in any case spread as widely outside as within the sphere of natural resources. A discriminatory tax treatment of property in natural resources, as such, has, therefore, no ethical justification.

Provided the dice are not loaded to give inequality of economic opportunity, the chances are that good luck will, in the lifetime of an individual, be largely canceled out by bad, and, so far as this is not so, there is nothing very effective to be done about it.<sup>3</sup> What seems to be, and probably is, luck in one case, may in another of precisely similar objective characteristics be the result of skill and foresight.

The *perpetuation* of any one type of luck, whether good or bad, through institutions covering successive generations is, nevertheless, a gross and remediable social evil. When property in natural resources is, like all other property, subject to the impact of restrictions on inheritance, the fact that it may be indefinitely durable will, however, have no sinister implications. The recurrently renewed sale of such property, to those whose means of payment will derive only from the exertion of inherent and socially legitimate powers, will prevent any indefinite engrossing of increment, will compel each new holder to pay for property the capitalized value of its prospective yield, will therefore give him no special privilege, will recurrently restore to the community the equivalent of its patrimony in natural resources, and will enable it to secure any benefit that changing conditions may cast up. Any holder, however, will be free to make what he can of the property, provided he uses it in a socially innocuous manner. His acquisition of the property will be in exchange for an earned *quid pro quo* and such returns as he may get from it will presumably be the result of socially effective, or at the least socially unobjectionable, utilization. To these he has an unassailable ethical title.

#### DIFFERENTIAL RETURNS NOT, AS SUCH, OBJECTIONABLE

It is often asserted that the rents on natural resources are one species of a genus of economic rents which have the common characteristic of being susceptible to confiscation without any diminution of the supply of the property from which they are derived and that, therefore, they should be taken by the state. It is true that

<sup>3</sup> The chances of a cancellation are much greater if the good, rather than the bad, luck comes first. Bad luck, striking early, may have cumulative effects which make the individual concerned incapable of taking advantage of any break in luck that he may have.

the supply of natural resources, in the strict sense of the term,<sup>4</sup> will not be diminished as a result of a withdrawal of their yield from the hands of a private holder. But the mere fact that a return can, without any deleterious effect upon social output, be abstracted from its current recipient does not justify the abstraction. There is no reason to suppose that any other individual, or the social group as a whole, has any ethical claim to the return. Any so-called rent of ability (a differential over the return on less competent services of a similar character) might similarly be abstracted from its recipient without a necessary, or even probable, reduction in the amount and quality of the services he would continue to supply. It would, however, be difficult to justify the abstraction except on the principles that reward should have nothing to do with desert and that no one is entitled to anything which can with impunity be taken away from him. There have been many attempts to provide a "philosophical" basis for such "principles" but none of them has been very convincing.

There seems, therefore, to be no reason, in the nature of things, for distinguishing rent from interest. The principal popular distinction is on the basis of the contract of hire. If the hired property is money the payment for the use is called interest; if the hired property is something other than money the return is called rent. The distinction is possible solely because, in the one case, the property and the yield are identical in type while in the other they are not. In the former case the yield can therefore be expressed as a rate.<sup>5</sup> The expression of a return as a rate rather than as an absolute sum is clearly convenient rather than vital. Since the prospective return to the supplier of property under a rental contract must, under free competition, tend to equate with that which can be obtained as interest on a loan of money of equal current value, it seems logical to assimilate rent and interest into one conceptual category.

#### TYPES OF OBJECTIONABLE RETURNS

The socially objectionable types of income are those which arise from the establishment and exploitation of a nuisance value. The

<sup>4</sup> That is to say, such part of the material resources of production as is in nowise the result of an expenditure of past or present labor.

<sup>5</sup> Cattle might similarly be lent on an interest basis, in cattle, and so with other things.

ownership of natural resources lends itself rather readily to this type of exploitation but it is the nuisance use or failure to use, rather than the ownership, to which objection can logically be taken. Certain natural resources, limited in supply, may be essential to any given type of production. It has already been noted that the partial restriction of the use thereof may enable the possessor of title to them to exact an indefinitely large return for so much of them as he puts at the disposal of lessees. But it is only so far as an economically illegitimate monopoly power is thus exercised by a holder or controller of natural resources that the validity of the return on them is open to forthright condemnation. Most other forms of tangible property, being readily reproducible, are not with such facility monopolized. It is difficult, therefore, to bend them to purposes of obstruction and it would seldom pay their owner to hold any of them persistently out of use. This is the principal practical distinction between natural resources and other types of property.

So far as rents of natural resources involve a monopoly, as contrasted with a merely differential, return, they are subject to the same objections as the returns to any other type of monopoly. So far as they arise out of the creation of positive obstructions to production they are on all fours with the returns that accrue to gangsters. In either case they are but one of a group of incomes, some of which have no association with natural resources and all of which must, in the social interest, be attacked. So far, however, as rents are nothing but differentials, established on a competitive basis between pieces of property graded from best to worst, they do not differ from the economically legitimate differences in reward to suppliers of any type of service of superior and inferior quality. The distinction between (legitimate) differential rewards and (illegitimate) monopoly returns rests on that between unavoidable and contrived scarcity.

In one important respect, however, it is essential to make a sharp distinction between property in natural resources and property in other things. Natural resources, as the patrimony of the state, must be used conservatively, that is, with reference to the extension of their use over the presumptively infinite life of the society. It is not easy—indeed it is not possible—to lay down any *precise* rule on conservation since (1) the relative claims of the

present and of future generations are incapable of accurate comparison and (2) any given present natural resource may, in some more or less remote future, lose all value through a change in technology or fashion. To have prevented its full use while it was valuable would thus have been nothing but an exercise in frustration. The conservation of wasting social assets, nevertheless, requires the intervention of the state in the interest of its unborn as against its immediate members whose estimate, as individuals, of their needs as against those of followers remote from them in time and, perhaps, in kind, will almost certainly fall short of objectivity. The necessity for intervention would become much more acute on the enactment of inheritance laws under which a present owner would have no personal interest other than the exhaustion, within his own lifetime, of the natural resource to which he held temporary title. The right to pass on to heirs a modest homestead would largely, or wholly, obviate the need for enforced conservation of most agricultural lands so long, at any rate, as farming is carried on, typically, by one-family productive units, but the rapid exhaustion, under pressure of short-run considerations, of forest and mineral resources must be prevented by the state.

#### STRATEGIC POSITION OF LENDERS OF MONEY NOT STRONG

In contrast with some natural resources, it is not easy to establish a monopoly of the supply of loanable money. The strategic position of ultimate lenders of money, as against economically competent borrowers, is, in consequence, not likely to be strong.<sup>6</sup> Especially when the spirit of enterprise is, for any reason, jaded, the rate of return on a loan will usually be low. Unless funds can be created by the lenders, as is the case with our present banking system, suppliers of capital in an economically advanced community would seldom, therefore, receive an incontinently large share of total income. Interest (and all rents assimilable to it) does not, in consequence, present a serious problem in distribution. Of course interest has been condemned time out of mind by some of

<sup>6</sup> Exploitation of the distress of economically *weak* borrowers is, on the other hand, an age-old problem. There are always large ostensible, and probably real, disparities in the structure of interest rates. The present discussion, however, is concerned solely with modal rates of interest.

those who wanted the use of funds without being put to the bother of saving them or of remunerating those who had practiced economic continence. It has, on the other hand, been defended both on the ground of the productivity of capital and on that of the widespread preference for present as compared with future goods. It would perhaps be better to explain the phenomenon of interest as such on simpler grounds than these, leaving the *height* of the rate of interest to be explained by the more subtle theories. So long as things have any value at all their use must be worth something. This something is interest. Interest is thus inherent in a situation in which economics has any meaning—that is to say, in any situation in which there is anyone with unsatisfied desires.<sup>7</sup>

The *height* of the rate of interest, in contrast with the phenomenon as such, is of great controversial concern. Though, under politically stable conditions and advanced economic development, the rate is not likely to be so high as to confer upon receivers of interest and rent a very large share of the social income, it is frequently contended that its height is of strategic importance in determining the volume of employment and therefore of total income. The principal proponent of the idea is Mr. J. M. Keynes who has placed emphasis on a lowering of the general rate of interest as a spur to lethargic enterprise. In reviewing Keynes's thesis I trust that I shall do him no more injustice than is inevitable in a summary account of a complex chain of thought. To reduce that injustice to a minimum, I shall so far as possible use Keynes's own words.<sup>8</sup>

#### THE KEYNESIAN THESIS

When output increases, says Keynes, aggregate real income is increased, but aggregate consumption, while increased, is ordinarily not increased as much as income. If the increased employment were devoted to the provision of consumption goods, the increased output could, therefore, not be sold at a pecuniary profit. Thus, to justify any given amount of employment, there must be an amount of current net investment sufficient to absorb the excess of total output over what the community chooses to consume when

<sup>7</sup> The only recorded case in which such a situation did not prevail was the Garden of Eden and, even there, it did not last long!

<sup>8</sup> The following paragraphs are a paraphrase of Keynes's statement in his book *The General Theory of Employment, Interest and Money* (Harcourt, Brace and Company, New York, 1936), chap. III.



employment is at the given level. It follows, therefore, that, with a given community propensity to consume, the level of employment most profitable to employers will depend on the amount of current net investment. The amount of current net investment will depend, in turn, on the inducement to invest, and the inducement to invest will depend on the relation between the marginal efficiency of capital and the rate of interest.

With a given propensity to consume and a given rate of net (i.e. new) investment there can be only one level of employment consistent with an equilibrium involving equality between the aggregate supply price of output as a whole and its aggregate demand price. This level cannot, of course, be greater than full employment, but there is no reason for expecting it to be equal to full employment. Full employment can exist only when, by accident or design, current investment provides an amount of demand just equal to the excess of the aggregate supply price of the output resulting from full employment over what the community will choose to spend on consumption when it is fully employed.

This analysis, Keynes continues, supplies us with an explanation of the paradox of poverty in the midst of (potential) plenty, since the mere existence of an insufficiency of effective demand may, and often will, inhibit the process of production, and bring employment to a standstill, in spite of the fact that the marginal product of, and return to, such labor as is employed may still markedly exceed in value the marginal disutility of employment.

The richer the community, moreover, the wider will tend to be the gap between its actual and its potential production. For a poor community will be prone to consume by far the greater part of its output, so that a very modest measure of investment will be sufficient to provide full employment, whereas a wealthy community will have to discover much ampler opportunities for investment if the disposition to save on the part of recipients of large incomes is to be compatible with the employment of the poorer members of the community.<sup>9</sup> The inducement to invest is, however, likely to be feeble in a wealthy community, since capital accumulation will

<sup>9</sup> Critics of this doctrine have pointed out that the marginal propensity to consume may, in the long run, be no less in a rich than in a poor community. The short-run variations in the propensity to consume will almost certainly, however, be much greater in a rich than in a poor community, and this is all that is essential to Keynes's argument at this point.

probably already be so great as to bring the marginal efficiency of a unit of capital to a low level. *The rate of interest must, in consequence, fall far if investment is to keep pace with the disposition to save.*

A lowering of the rate of interest through monetary manipulation is, in Keynes's view, the key to the dilemma. Unless such action is taken, the inducement to invest in a wealthy community will, he avers, remain weak, and in spite of its real, and still greater potential, wealth, the working of the principle of (insufficient) effective demand will compel a reduction of output until the community misses its great opportunity and becomes, at least temporarily, so poor that its surplus over consumption is sufficiently diminished to effect a correspondence with the weakness of the inducement to invest.

To the question why the rate of interest does not automatically fall to the level necessary to provoke equilibrium of savings and investment, along with full employment, Keynes replies that the interest rate is not, as classical economic theory alleged, a function of the supply of and demand for real capital, which it moves to equate, but of the preference for liquidity.

#### CRITICISM OF LIQUIDITY PREFERENCE THEORY OF INTEREST

If, however, as is asserted above, rent and interest are but different forms of expression of the same thing, interest being merely rent for the use of money, the preference for liquidity can have no bearing on the rate of interest. Rents are the return on non-fungible, that is, illiquid, things, and, so far as interest is analogous to them, it must therefore be for something other than the forgoing of liquidity that interest is paid. It is true that the degree of preference for liquidity will affect the charges on money loans, according as the loans are regarded as liquid or illiquid, but the differences are risk premiums rather than interest. This is shown by the fact that the charges on money loans will be relatively high when there is a strong aversion to liquidity as well as when there is a strong preference for it.

Great alterations in the preference for liquidity are always attributable to fear. This fear is of two kinds. The one is that an investment will yield no monetary return. The other is that, while the investment may yield a substantial monetary return, the money

which is repaid on the loan will be of low real value relative to that which was lent.<sup>10</sup> The one fear will be strongest in a deflationary, the other in an inflationary, situation. Charges on money loans will thus follow a U-shaped curve, falling on the one arm and rising on the other, as a deflationary situation is checked and is replaced by the prospect, or fact, of inflation. But, at the bottom of the U, where there is no special preference for liquidity, or the converse, the charges on absolutely riskless loans would be something considerably above zero. For, if they fell to zero, the conclusion would be that, under normal conditions of liquidity desire—that is, in an ordinary business situation where there was no fear either of deflation or inflation—the use of property and, therefore, property itself, was without value. This is obviously not the case, and the preference for liquidity can thus not be the unique explanation of interest, though, as will presently appear, it may affect the relationships *within* the general structure of charges on loans.

The charges on loans are partly compounded of a pure rate of interest—for the use of capital without any risk to the lessee—and of a premium for the risk which must attach in some degree to every loan. It is this premium for risk, rather than the rate of interest, which makes for the difficulty between lenders and borrowers when the preference for liquidity is high.

The premium for risk is directly associated with the uncertainty in which the *ex ante* schedule of marginal efficiency of capital is bathed. The greater the degree of uncertainty attached to the current schedule of the marginal efficiency of capital the higher will be the risk of investment, and the higher, in consequence, will be the charges on loans for investment in capital goods.<sup>11</sup> But,

<sup>10</sup> The whole of the argument turns, of course, on the possibility of borrowing (with later repayment of a *fixed* amount of money) by an enterpriser who invests the borrowed capital. It has no relevance to direct investment of funds in equity securities.

<sup>11</sup> The difference between uncertainty and risk, elaborated by Professor Frank H. Knight, must always be kept in mind. "Uncertainty must be taken in a sense radically distinct from the familiar notion of Risk, from which it has never been properly separated. The term 'risk,' as loosely used in everyday speech and in economic discussion, really covers two things which, functionally at least, in their causal relations to the phenomena of economic organization, are categorically different. . . . The essential fact is that 'risk' means in some cases a quantity susceptible of measurement, while at other times it is something distinctly not of this character; and there are far-reaching and crucial differences in the bearings of the phenom-

when those who think that the future of business is merely uncertain are widely regarded as optimists, the charges will be prohibitive. It is typical of depression conditions that the current marginal efficiency of most capital goods is below zero. This is shown by the fact that at such a time there is a large amount of them lying idle. Most capital goods are at such times a peculiar type of property which, except as a reflection of a deferred potential usefulness, has no value. Interest rates on loans for investment in such goods (at prices sufficient to cover their costs of production) will then be high and, so long as the prospect remains unchanged, the attempt to reduce them must prove abortive.

It is, however, not so much the lender's as the borrower's preference for liquidity that inhibits investment. There can be no inducement to invest until the marginal efficiency of capital goods is positive.<sup>12</sup> Without this it is irrelevant what the charges on loans, for purposes of investment, may be. Borrowing will not, in any case, take place.<sup>13</sup>

enon depending on which of the two is really present and operating. . . . It will appear that a *measurable* uncertainty, or 'risk' proper, as we shall use the term, is so far different from an *unmeasurable* one that it is not in effect an uncertainty at all. We shall accordingly restrict the term 'uncertainty' to cases of the non-quantitative type. It is this 'true' uncertainty, and not risk, as has been argued, which forms the basis of a valid theory of profits. . . ." (Frank H. Knight, *Risk, Uncertainty and Profit*, reprinted by The London School of Economics and Political Science, London, 1933, pp. 19-20.) Note that uncertainty always involves risk but that risk does not necessarily involve uncertainty as Knight defines the term.

<sup>12</sup> Keynes, of course, appraises the marginal efficiency of capital according to expectations of its yield over its life but he implicitly assumes that these expectations have a precision which, in truth, is wholly lacking. The yield, as noted above, will depend upon that volume of employment (and business activity) which actually develops over the course of time but it is certain that businessmen have no *rational* conviction of developments in employment, and business activity, over the period for which long-term investments are made, and it is highly dubious whether they have any convictions at all covering these matters over any lengthy period. The plain fact is that investments are made or not made on the basis of an irrational optimism or pessimism to which a close appraisal of probabilities is alien, even if it were possible.

<sup>13</sup> Where the preference for liquidity is rising, both the supply and the demand schedules for loanable funds will drop, and for the same reason, viz., the fear of a loss which may strike both the borrower and the lender for purposes of investment. The structure of supply will shift, moreover, away from loans of infinitely distant maturities (equities), through long-term, to short-term and call loans. The structure of demand shifts in the opposite direction. Call and short-term rates will therefore sink toward zero. Securities of infinitely distant maturity (equities) will show high yields (low capital values). Long-term rates, though falling (since any long-term

The marginal efficiency of capital, which Keynes takes as a determinate and positive datum, is in fact highly uncertain, variable in direct correspondence with the rate at which the economic system as a whole is from time to time operating, and possibly negative. Capital goods will always have some positive technical efficiency but it does not follow that they can be made to yield a monetary return. Whether they will do so or not is largely dependent on the general level of employment. Anticipations of the general level of employment, whatever they may be, tend in the short run to be self-vindicating. If hopes are high, the consequent new investment, with heightened production, will raise the marginal value efficiency not only of the new but of all capital in the higher rate of profits which will then develop. If, on the other hand, fear is prevalent, the lack of new investment will depress the returns on existing installations and seem to justify the decision to refrain from throwing good money after bad. This, no doubt, leads enterprisers to think that they are much wiser than is the case, a

security will mature at a time nearer to the present than to an infinitely remote future) will remain fairly steady. (The fall shown by the statistics will be somewhat exaggerated because of the shortening of the totality of maturities, on such issues, from the lack of new placements.)

Where there is a rising preference for *illiquidity*, but this is moderate, both the supply and the demand schedules for loanable funds will rise since the borrower will expect to make money and the lender will have little fear that the loan will not be repaid. The structure of supply will shift from call loans, through long-term, toward loans of infinite maturities. The structure of demand shifts in the opposite direction. The rates on call and short-term loans will then rise, the yields on stocks will fall (rise in their capital values), while the rates on long-term bonds will show but a slight rising tendency, somewhat exaggerated in the statistics by reason of the lengthening of average maturities, on the totality, through the issue of new bonds.

Where there is a *very* high preference for illiquidity (highly inflationary conditions) the charges on money loans of all types will rise rapidly, with those on the longer, but not infinite, maturities outpacing all others. The reason is that borrowers will be urgent and lenders reluctant. On investments in equities, however, the rate will not be extremely high since the fear of a loss in the value of the money yield is in part compensated by the expectation of higher pecuniary returns. Keynes's argument deals, of course, on the borrowing and lending side, only with securities fixed in money terms. An investment in equities does not involve a loan contract, or any relationship between lenders and borrowers on different sides of the fence, since the investor in equities does not really forgo ownership of his money property, in exchange for a future claim to a definite sum of money, but merely puts money into goods through an agent rather than a principal. Money is on both sides of a loan but only on one side of an investment in equities.

fact which does not improve the situation. Whenever business is good, enterprisers will ask and receive prices which will give a marginal efficiency to capital adequate to cover whatever the interest charge may be; when it is unmitigatedly bad they will not want new capital at all and will thus be indifferent to the rate of interest. In some, on the whole unusual, state of business, neither good nor bad, the rate of interest might, however, be of real importance to enterprise.

The marginal efficiency of capital in terms of the money rate of return on a money value (which alone can make it comparable with a rate of interest) must depend on the evolving volume of investment (as the determiner of the volume of employment, of business activity, and, therefore, of profits) but the evolving volume of investment, according to Keynes, depends, on one side at least, upon the marginal efficiency of capital. It is true, of course, that any spread between current rates of interest and what would, at optimum economic activity, be the marginal efficiency of capital, might be a possible stimulus to enterprise when the interest rate is the lower of the two and economic activity is below optimum level. But while this is a possible it is by no means a probable stimulus. The assumption involves an hypothesis on the motivation to enterprise which seems quite unwarranted. Potential enterprisers do not, normally, engage in close calculations of the spread between the marginal efficiency of capital, however computed, and the rates at which they can borrow money. Interest is usually a minor factor in their considerations.<sup>14</sup> They certainly do not take a decision in favor of expansion, when depression is on them, merely because the rate at which they could borrow money is below what the marginal efficiency of capital would be if the depression should disappear. On the contrary, it may be asserted with confidence that enterprise in a state of depression is essentially dependent upon guesses, more or less shrewd, as to a baffling list of uncertainties. Marginal analysis, which is quantitative, is dependent upon assumptions which must more or less closely approximate certainty, that is, they must be capable of being

<sup>14</sup> If anything would serve as a stimulus it is the lowering of wages, rather than rates of interest, but it has already been demonstrated that this would be far from certainly effective.

brought within a scale of probability. It has no place in a situation where such certainty is excluded by the nature of the data.<sup>15</sup>

For many of the decisions of an enterpriser marginal analysis is, of course, a useful tool, and all good business administrators, whether consciously or not, must make use of it. In appraising methods of production, the effect of volume of output upon unit costs, the bearing of given consumer demand schedules on the price at which a given total output can be sold, and many similar matters, it is indispensable. But it is valid only so far as one may assume either that existing conditions will remain substantially unchanged over the period for which decisions are relevant or that such changes as will occur can, at the moment, be subsumed in a scale of greater or lesser probability.

The *typical* decisions of an enterpriser are, however, those which involve the assumption of an unmeasurable risk. Risk is inevitably and closely associated with uncertainty. There would, in fact, be no uninsurable risk if there were no uncertainty. The greater the uncertainty the smaller is the opportunity for the use of scales of probability.<sup>16</sup> As things have been in capitalistic economies there is no reason to suppose one development rather than another in

<sup>15</sup> Keynes seems here to be deep in the pit in which he finds the classical economists. It is a pit which is ever open to swallow those who are excessively ambitious to make economics "scientific," that is, to reduce it to precisely measurable phenomena by a method of abstraction which involves assumptions far from real. Despite the enormous amount of research that has gone into the study of economic fluctuations, with the hope of accurate prediction as one of the major incentives, the ablest investigators admit that, under existing conditions, it is an illusion to suppose that the course of business in the near or more distant future can even roughly be foreseen. This, no doubt, accounts for the allegedly not uncommon resort by businessmen to professed clairvoyants, rather than to more reputable business "forecasters," in a desperate essay at gauging the shape of things to come.

<sup>16</sup> This is not true of mere risk. An event may be certain to happen (e.g. death) and be merely uncertain as to time. Or it may be of the type which, while not completely inevitable, is practically certain to happen to a fairly definite percentage of a given (large) number of people within a specific time (fire, hail storms, etc.). Or it may, while inevitable, be uncertain only as to amount (taxes). Any combination of these types of uncertainties may occur but, if they are measurable among large numbers of people or over long periods of time, they are insurable, and the pecuniary *risk* associated with them can therefore be removed from any individual. But the uncertainty with which the businessman typically deals is absolute. There is no inevitability about many events and, even where one is inevitable, its incidence as to time and amount is veiled in complete obscurity. This is true not only of the enterpriser as an individual but of enterprisers as a

the course of general business over the term for which, under the existing technique, investments must be made. Marginal analysis is, in these circumstances, quite irrelevant. The enterpriser is dealing with thoroughgoing uncertainties among which are not only the long-term course of general business activity but of prices and of total demand. In these circumstances the entrepreneur's decisions are necessarily made without any precise knowledge of what the marginal efficiency of capital will be. By calculation of such probabilities as there are, of varying degrees of likelihood, the enterpriser can eliminate certain projects and bring others into the range of consideration, but he cannot, at best, do much beyond this except to proceed by guess. He is to a large extent the minion of an unknown environment which will later envelop him and which, in a fully competitive situation at least, he has no power to change in his own interest.<sup>17</sup>

Some enterprise will always be undertaken by men with a fanatical faith in their projects, but the bulk of enterprise lies in the hands of more normal characters whose estimates of the chance of success are formed on the basis of conditions in the recent past, except so far as their judgment is qualified by the waves of optimism or pessimism which, under existing conditions, sweep the entrepreneurial world. The influence of immediately preceding business history, whether that history has been good or bad, will occasionally be broken by a shift of subjective attitudes without any apparent objective cause, and sometimes it will be overridden by external events, in the business world or elsewhere, which give some reason to suppose that recent experience will be reversed. For the most part, however, it seems to be a fact that businessmen presume the indefinite continuance of an existing situation.

An alteration in a situation of depression which goes no farther than the establishment of conditions of "easy" money is quite inadequate to induce enterprise. This may lead to a lowering of charges on loans for financial purposes, in cases where risk is

whole, since the *scope* of any occurrence adverse to business is as much an impenetrable secret of the gods as is any other facet of the phenomenon.

<sup>17</sup> A prominent businessman once regaled the writer with the history of his forebears and their successful friends as enterprisers. The burden of his story was their repeated failures, and eventual success, in various business enterprises in which a wholly unforeseen development proved decisive.



negligible, but it will not greatly affect the charges on loans for investment where the risk is high.<sup>18</sup>

But if an unlimited demand for goods is established, under a resolute policy to keep business activity at an optimum, the marginal efficiency of capital will be raised to its current maximum and, with a diminution of all types of risk, the charges on loans will fall toward the bottom of the U. Any aberrational disparity between the marginal efficiency of capital and charges on loans for investment will then tend to disappear. There will always be an inducement to invest when business is brisk, and profits can seldom be so finely gauged in advance as to make any normal rate of interest a factor of decisive importance.

Interest and the marginal efficiency of capital are not disparate. No money loan contract can be completely riskless to the borrower, and interest is always embodied in a matrix which includes profits. Profits, on the other hand, ordinarily include an element of interest. There is always risk in waiting and always waiting in risk. It can never be assumed as certain that any borrower will be able, or can be compelled, to repay a loan fixed in terms of the money designated in the contract. The lender of money devoted to enterprise is therefore, *volens nolens*, a participant in the risks of the enterprise, especially if his loan takes the form of a purchase of the bonds of a corporation where the liability of the borrower cannot be pressed beyond the assets of the enterprise as such.

There is nowadays, indeed, not much difference, except in *degree* of risk, between the bondholder and the great bulk of holders of the equity securities of a business corporation who are the ostensible enterprisers. The actual control of the corporation is typically no longer in the hands of stockholders as such but in those of a minute minority of them or of a self-perpetuating group of directors who may hold very little stock. Routine management is in the hands of salaried officials. The stockholders preserve the

<sup>18</sup> Low rates of interest in the short-term money market, when money is plentiful, apply almost solely to loans of the former type and not to those which are to be applied to an expansion of enterprise that involves any considerable degree of risk. The low rates on short-term financial transactions are not much more than charges to cover the cost of transfer from one type of liquid funds to another only slightly less liquid. Such rates may be accompanied by very high charges on money loans, to be sunk in fixed investments, by borrowers who cannot offer quite unimpeachable security.

character of enterpriser, rather than that of mere investor, only in that they assume the main burden of risk of lack of success in the conduct of the corporation. This, of course, is a vital function but it is borne in some degree by the bondholders also who, if the stockholders are enterprisers, must be held to be, in part, enterprisers as well. The bonds of one corporation may be a much more risky investment than the stock of another.

On the other hand the risk which is inseparable from enterprise must be, primarily, a risk of loss of staked property or wealth of some sort. (About the only things beyond this which could be risked are the enterprisers' time, reputation, or future earnings, all of which might be regarded as, in some sense, property.) Since enterprisers all but inevitably engage their property, directly or indirectly, in the affairs for which they take responsibility, interest is mixed up in those returns which, so far as accounts are concerned, are set down as profits. It may be observed that, if interest were in fact a payment for forgoing liquidity (the assumption of risk), interest would be what in economic theory has usually been regarded as pure profit, viz. the reward for risk-taking. This would eliminate interest altogether as a category of income.

Some payment for the assumption of a risk, presumptively greater than that attached to investment in the safest bonds, may, of course, be necessary to effect the shift of marginal units of investment from the fixed interest to the equity category. There will, however, be no sharp dividing line between the return on "riskless" loans and that on risky investments, but merely a "continuity classification" of risk and return, proceeding steadily from that on the bonds of a strong, stable, financially impeccable, and fiscally conservative government to that on the stocks of highly aleatory enterprises.<sup>19</sup>

The notion of a loan contract between lenders who take no risk and entrepreneurial borrowers who put up none of their own capital (a notion implied in the contrast between the rate of interest and the marginal efficiency of capital, with the discrepancy between them which is supposed by Keynes to stimulate enterprise) is, therefore, unreal. Since the differences between the func-

<sup>19</sup> The maturity of a financial instrument is always a factor in the risk which attaches to it since *any* adverse event is more likely to happen within a longer than within a shorter period.

tions of holders of fixed interest and of equity securities are matters of degree, with both groups taking risks and putting up capital, we cannot long expect a spread between actual rates of interest on loans for investment purposes and the anticipated marginal efficiency of capital in general. The operation of the principle of substitution in investments will, in a not very long run, eliminate any substantial discrepancy between them.<sup>20</sup> We may thus conclude that an attempt to establish a spread, between rates of interest on loans for investment and the marginal efficiency of capital in general, is bound to fail.

If, then, the marginal efficiency of capital and interest rates tend to coincide we must look for the inducement to invest elsewhere than in a discrepancy between the two. The fact is that the borrower of capital on interest usually expects to use it intramarginally by capitalizing on his presumptive special ability as an organizer of production or as a forecaster of the character of future demand.<sup>21</sup> He may, however, merely prefer the chance of prizes and penalties to any stable income that he could earn, as wages or interest, and he will then borrow even when his anticipated return on the acquired capital is the precise actuarial equivalent of the interest he must pay. There are thus inducements to borrow capital for investment purposes even though the interest paid is equal to the general marginal efficiency of the capital and, provided this equality is maintained, the inducement to invest is not at all affected by the absolute height of the rate of interest.

The smaller the supply of capital, relative to labor and enterprise, the higher will be its marginal efficiency and, in correspondence, the higher will rates of interest be. There is, in consequence, no reason for supposing that the absolute height of interest rates would, per se, ever inhibit production. All that augmented interest rates will certainly do is effect a shift in the proportions between capital and other factors used in the productive process.

The absolute height of interest rates is thus of no significance to an unimpeded working of the economy. Persistently high rates of

<sup>20</sup> Certain failures of competition might, however, preserve aberrations for more or less lengthy periods.

<sup>21</sup> If any marginal enterpriser were certain that he could use borrowed capital no better or worse than marginally, it would be a matter of indifference to him whether he borrowed or not.

interest are, indeed, normally associated with active enterprise, as would be expected from the fact that profits practically always contain an element of interest in payment for the use of the enterpriser's own property.

Profits do not ordinarily disappear because the interest rate is excessive. It is merely that any positive rate of interest seems excessive when profits disappear. Interest is much more dependent on profits than profits on interest. It is not that the preference for liquidity raises the rate of interest but that, without *reducing* interest and other costs, it reduces profits, and therefore the current marginal efficiency of most capital, to zero or below, which is of preeminent import in causing stagnation.<sup>22</sup> Provided profits in general are kept positive by the maintenance of full economic activity, with wages pressing on profits so far, and so far only, as is consistent with the continuance of production, the marginal efficiency of capital and the rate of interest will not deviate from parity.

The resolute establishment of full employment, at a stable price level, would remove most, if not all, of the factors making for a preference for liquidity among potential lenders of funds. There would be no such chance for higher rates of interest in the near future as, in the present economy, is attendant upon the eventual replacement of depression by boom. Nor would it be worth while to hold money back in the expectation of a falling price level. The only circumstance which would then occasion any preference for liquidity would be a drop in interest rates to such low levels as to make hoarding seem more desirable to potential lenders than the making of loans, even under conditions in which risk was at a minimum. This does not seem a very probable occurrence and it

<sup>22</sup> cf. J. R. Hicks, *Value and Capital* (Clarendon Press, Oxford, 1939), p. 226, where it is pointed out that "interest is too weak for it to have much influence on the near future; risk is too strong to enable interest to have much influence on the far future." cf. also, Clarence D. Long, *Building Cycles and the Theory of Investment* (Princeton University Press, Princeton, N.J., 1940), p. 29, for the passage in which Long says that "if [as is true] interest is a minor factor in inducing investment in the building industry, it must be minor indeed as an inducement factor in the great mass of other, less durable, classes of investment goods." Long has some tables (*ibid.*, chap. 11) showing that the terms of amortization are of much greater importance than interest rates as an inducement to invest in building. It should be remembered, moreover, that nearly all investment is building of some sort.

could scarcely develop at all under inheritance laws which would operate to diminish saving. If it should nevertheless happen, any possible concern about an unduly large share of total income accruing to lessors of property would disappear.

With the removal, however, of the risk of a general slump in output, both the charges on loans and the average rate of profits might, *ceteris paribus*, be expected to fall somewhat. This would make for a larger use of capital, relative to other factors, in the productive process. The urge for liquidity being diminished, there is every reason to suppose that the rate of interest would then move to equate savings and investment in the manner assumed in orthodox economic reasoning. Such equation would, in all probability, occur at a level which would absorb in interest, and therefore in rent and to some extent profits, even a smaller share of total income than in the past.

With hoarding compensated under a commodity reserve money, moreover, the preference for liquidity would have no effect on production, or on the receipt of income, even if an equation of savings with ordinary investment did not occur. All that would be affected would be the use made of money income and the size of the commodity reserve. The possible expansion of this reserve beyond any generously estimated emergency requirements would merely call for the measures suggested in Chapter V.

There are no precise criteria, under any given circumstances, of the optimum rate of interest. The relative claims of present and future generations, which would be realized in converse degree according as the interest rate reflected a smaller or larger volume of saving, are incapable of a purely rational solution. Within not very narrow limits the rate of interest is, therefore, a matter if not of social indifference at least of indeterminate importance.

When the exigencies of borrowers for purposes of consumption have been much alleviated by the provision of full and steady employment at a stable price level and when, under such conditions, risks have been limited and the marginal efficiency of capital has become capable of fairly precise determination, there is small reason to anticipate that lenders will ever have any particularly favorable strategic position and thus arrogate to themselves an unwarranted share of total income. The returns to the lessors of property can then be left quietly to settle where they will.

## CHAPTER X

### BIG BUSINESS AND FREE COMPETITION

#### THE MEANING OF FREE COMPETITION

THE terms "competition" and "free competition" have so far in this book been generously employed without the provision of specific definition. In view of the fact that "free competition" may mean all things to all men, and has connotations ranging all the way from a strict economic definition to vague notions virtually synonymous with any type of private enterprise, a more precise analysis, applicable to modern economic institutions, is clearly required.

In orthodox economics, free competition was conceived of in terms of a market composed of many small buyers and sellers no one of whom had the power appreciably to influence price or the volume of total output. The institutional pattern from which this theoretical framework was "abstracted" may have prevailed in some measure, though probably not to the degree generally supposed, during the historical period in which classical economic thought was constructed. In any case it is not present now. Its characteristics were: (1) small-scale enterprise run by the owner-enterpriser; (2) a high degree of fluidity in the system with the rapid elimination of the "errors of competition" at little real social cost. Out of this institutional picture, partly real and partly a figment of the imagination, orthodox economics fashioned its ideal of economic organization in the ethereal form of a world of *perfect* competition. Free competition was to be a spreader of the social gains and an eliminator of the individual losses (along with the losers, as enterprisers) from any improvement in productivity.

There can be little doubt that, if we are forced to conceive of competition (either pure or perfect) in this orthodox sense, then Professor Arthur R. Burns's appraisal of the drift of economic events may be accurate when he says that the "rise of the 'heavy industries,' changes in methods of selling, and the widening use of corporate forms of business organization are bringing, if they have not already brought, the era of competitive capitalism to a close."<sup>1</sup> Or, as expressed by Professor Gustav Cassel, long before

<sup>1</sup> *The Decline of Competition* (McGraw-Hill Book Company, New York, 1936), p. v. Critics have pointed out, however, that Burns offers no convincing evidence of a *trend*.

the present hue and cry over imperfect and monopolistic competition, the "idea [of perfect competition] . . . is . . . quite irreconcilable with a matter of great importance in the modern economic life—the economic superiority of the large business."<sup>2</sup>

#### THE PASSING OF FREE COMPETITION

It was the economies of scale for the individual firm which gave the *coup de grace* to the more or less close correspondence of the institutional structure with the ideal of pure competition. With costs falling, as individual firms in many industries expanded output, pure competition in major sections of the economy gave way to monopoloidal conditions. In this historic process, production was increased, prices as well as costs were appreciably lowered, and social economic potentialities were greatly expanded. We could not reverse the process without great loss of social power.

Despite the fact that this transformation of competition was well under way as early as the middle of last century, modern economics has, until comparatively recently, been loth to admit the obsolescence of the orthodox framework of thought. Indeed, it has been only within the last decade that Mrs. Joan Robinson has conjured up her "world of monopolies"<sup>3</sup> and Professor Edward H. Chamberlin has called for a "new economic *Weltanschauung*" in which the familiar dichotomy between the concepts of competition and monopoly is to lose much of its traditional and hallowed significance.<sup>4</sup>

The publications of Professor Chamberlin and Mrs. Robinson released a flood of treatises, articles, and convention addresses, implemented with much geometry, on the "discoveries" with respect to the internal economies of the firm and the differentiation of products. While much of this has been of dubious value, as is inevitable in the process of clarifying "new" concepts, a better understanding of competition and of monopoly has been attained.

<sup>2</sup> *The Theory of Social Economy*, translated by J. McCabe (Harcourt, Brace and Company, New York, 1924), p. 126.

<sup>3</sup> *The Economics of Imperfect Competition* (Macmillan and Company, Ltd., London, 1934).

<sup>4</sup> "Monopolistic or Imperfect Competition?" *Quarterly Journal of Economics*, vol. LI, August 1937, pp. 557-580. cf. also *The Theory of Monopolistic Competition* (Harvard University Press, Cambridge, 1933), by the same author.

Perhaps the major result of the discussions of monopolistic, or imperfect, competition has been the recognition of the facts that the difference between competition and monopoly is a matter of degree rather than of kind and that "the limitations on competition can be due to purely economic causes, to the conditions of production and of consumption, and not only to the operations of that sinister group of individuals, 'the institutional monopolists.'"<sup>5</sup> With the abandonment of the simple monopoly-competition classification of types of market behavior there has also come a recognition of the fact that the concept of pure competition, long known to be inadequate as a category of description, is also deficient as a norm of economic efficiency.<sup>6</sup>

The intricacies of the economics of the firm, which, in the view of some critics, have been treated *ad nauseam*,<sup>7</sup> the problems of differentiation of products, those of excess capacity under imperfect and monopolistic competition, and the like, will not here be discussed. The literature on them is voluminous and can be understood, in the main, only by the "expert." What is of immediate interest, however, are the implications of the analysis of imperfect competition for the essential purposes of the private economy. Most theorizing on imperfect (and monopolistic) competition has been concerned with the construction of analytical tools rather than with a broad appraisal of the import of large-scale enterprise for economic well-being and social policy. Of the few attempts to derive a workable concept of competition for the modern world, and this is the sense in which the term competition is conceived here, that of Professor J. M. Clark is probably the most valuable contribution.<sup>8</sup>

<sup>5</sup> N. Kaldor, "Professor Chamberlin on Monopolistic and Imperfect Competition," *Quarterly Journal of Economics*, vol. LI, May 1938, p. 524.

<sup>6</sup> Professor Chamberlin seems to be much more realistic on this score than Mrs. Robinson, and with her the whole Cambridge welfare school. Thus he says: "The explicit recognition that product is differentiated brings into the open the problem of variety and makes it clear that pure competition may no longer be regarded as in any sense 'ideal.' In many cases it would be quite impossible to establish it, even supposing it to be desirable." cf. "Monopolistic or Imperfect Competition?" *Quarterly Journal of Economics*, vol. LI, August 1937, p. 577.

<sup>7</sup> cf. J. R. Hicks, *Value and Capital* (Clarendon Press, Oxford, 1939), chap. vi.

<sup>8</sup> "Toward a Concept of Workable Competition," *American Economic Review*, vol. xxx, June 1940, pp. 241-256.



## WORKABLE COMPETITION

Clark emphasizes three factors which tend to mitigate the evils of monopoly, or oligopoly, in the present-day economy. First, he points out that both the long-run cost curves and the long-run demand curves of individual productive units are much flatter than usually indicated in diagrammatic treatments of monopoloidal conditions in theoretical expositions.<sup>9</sup> This means that the spread between marginal cost and price is not as large as may have been indicated or, in general terms, that oligopoly profits are not likely to be exorbitant. Second, Clark affirms that long-run anticipations of cost and demand conditions play a more important role in entrepreneurial decisions than has been intimated in some of the literature on imperfect and monopolistic competition, and that it is, in fact, by these rather than by the prospects of immediate gain that even short-run policies on prices and production are determined. Finally, Clark indicates that, both because of the tendency of the long-run curves to flatten out, and because businessmen are in a measure cognizant of long-run probabilities, actual competition (including the threat of potential direct competition as well as replacement by substitute commodities) is, in many markets which must technically be defined as imperfectly competitive, sufficient to be workable. That is to say, it is sufficient to prevent the engrossing of a monopoly share of total output.

While Professor Clark does not undertake to estimate the proportion of the economy in which a reasonable degree of effective competition prevails it is not unlikely that he thinks of it, perhaps rightly, as by far the largest sector.<sup>10</sup>

<sup>9</sup> "In fact, it may appear that much of the apparent seriousness of Professor Chamberlin's results derives from what I believe to be the exaggerated steepness of the curves he uses to illustrate them." J. M. Clark, *ibid.*, p. 246.

<sup>10</sup> Where, of course, free competition in this sense cannot be maintained, government intervention of a rather drastic type is required. The character of this intervention will vary with the particular case in question and may range from yard-stick competition to public ownership. The possible alternative lines of government attack on the problem are many. In some cases the enforcement of the anti-trust laws may be sufficient. If not, forms of normative competition might be established by the government on the yard-stick principle. A still more powerful weapon is direct price control. Price control and the yardstick principle may be combined as in the case of the utilities. And, beyond these techniques of control, lies the possibility of the quasi-public corporation or direct public ownership.

## CORPORATIONS AND COMPETITION

Despite this note of optimism concerning the area in which effective competition may be maintained, and power harnessed without direct and continuous government intervention, it would be a mistake to infer that free competition will generally and necessarily be the outcome of the play of market forces.<sup>11</sup> Eternal vigilance is the price of economic as well as of political freedom—if the two can be spoken of separately—and the maintenance of the free market requires constant surveillance of the market milieu. A naive faith in the beneficence of natural forces has characterized the general attitude toward economic development in the past and has led to a passive acceptance of the surreptitious accumulation of illegitimate power in many vital quarters of the economy. Of primary importance among the threats to the continued maintenance of workable competition at the present time is the virtually unlimited power which may be accumulated through the use of the corporate form of organization. The corporate pattern is so obviously the dominant type of business organization, and its portent for the modern economy so great, that it merits special attention as the medium through which a “bigness,” quite out of proportion to the requirements of efficiency for anything except purposes of exploitation, is most readily achieved.

Until comparatively recent times the privilege of incorporation was very grudgingly granted to business concerns. Legislatures gave it, if at all, only in specific acts to specific companies for specific purposes which could not be attained in other ways. Toward the middle of the nineteenth century, however, in the various states of this country and in Great Britain (somewhat later in France and still later in Germany) general incorporation legislation began to appear. The movement in the several countries was largely spontaneous, i.e. not greatly affected by what was occurring, or had occurred, abroad, and frequently was such as to give

<sup>11</sup> Marginal cost curves may be flat (in the sense that they are not sharply inclined) but also kinky. If the average revenue curve of any given firm were highly elastic, the spread between marginal cost and price would be small, but there is no good reason for assuming this under oligopolistic conditions. A high degree of elasticity in the demand for such a firm's product, over the full range of its output, can be assumed only if the entire market demand is expanding at a rate sufficient to keep ahead of the expansion of capacity.

discretion to an administrative officer of government to grant or withhold incorporation privileges under a general act. This limitation soon disappeared in the conferring of a general *right* of incorporation on condition of adherence to prescribed rules of procedure, with "protection" of the several interests involved.

Unincorporated joint stock companies had of course been long in existence, without benefit of legislation, but they could, as such, not bring suit. It was the pressure to obtain for corporations, or for an officer of the corporation acting on its behalf, the right to sue, that furnished the original impetus to the enactment of general statutes of incorporation. The right to sue was first conferred on unincorporated joint stock companies. These companies, however, did not obtain the privilege of limited liability which was inherent in corporations under the common law. The combination of these two privileges in a single organization was eagerly sought and was rather generally granted to corporations in Anglo-Saxon countries in the latter half of the nineteenth century. In the English Act of 1862 unincorporated joint stock companies were outlawed but such companies, without limited liability, are still legal in certain American jurisdictions.

The right of corporations to sue, all but essential to the use of the corporate structure for business purposes, conferred on corporations no *special* privileges, and gave them no discriminatorily favorable status, since the liability to be sued went with the power to sue. So much, however, cannot be said of limited liability which, in the eyes of enterprisers, immediately established the superiority of the corporate form of business organization and gave it a marked competitive advantage over businesses conducted by private persons.

Privileges which, in the social interest, had been long, jealously, and properly, guarded by the state were now conferred on corporations with so lavish a hand as to cease to be regarded as privileges though they continued to carry the seeds of discrimination against the public good. The competition among the several states in this country, to secure the pottage of legal charges for incorporation, led to a rapid disintegration of precious safeguards of the public interest. The ingenuity of lawyers, employed at fat fees by existing and embryonic corporations to wheedle new privileges and powers for their clients, was, in consequence, crowned with

success. The blindness, incompetence, or corruption of courts furthered the process until, like Parliament, there was little that corporations were not legally empowered to do and slight obstruction to their acting as they pleased. As legal "persons" they were given all the privileges of natural persons but, since they were capable of indefinite growth and were immortal, they accumulated power which it would have been impossible for a natural person to retain and all but impossible to acquire.

The most grasping corporations were thus favored in the race for commercial supremacy. Power, as always, was centripetal in its tendency. Since little was done to keep power diffused, and to preserve economic freedom by the system of checks and balances which had proved its worth in the field of politics, the freedom of competition was gravely impaired. This was, in part, a consequence of its own pristine exuberance but, however that may be, great corporations began to dominate the scene in most phases of industrial and, to a lesser extent, commercial activity.

#### CORPORATIONS AND THE ENTHUSIASM FOR ENTERPRISE

The larger the corporations grew—i.e. the greater the aggregation of property within a single entity—the less venturesome the policy of those in control became. The assumption of the risk of the loss of so great a stake became anathema. The risk was therefore thrown off by the arbitrary use of the power that had been acquired. The peculiar function of the enterpriser was thus renounced by those into whose hands almost the whole of business was falling. It was more important to preserve what one had than to take the chance, in venturesome business, of making a higher rate of profits on peril of bankruptcy. The disposition toward a misuse of power was fortified by technological changes which specialized capital to given functions, reduced its mobility, and therefore rendered it a valueless "asset" if the plant in which it was embodied ceased to be profitable. The quasi-monopolistic power which the domination of an industry often gave to one or a few concerns enabled them more easily to pursue a cautious policy without danger of loss of business to more daring competitors and indeed, in certain circumstances, made it possible to throttle potential competition in the cradle, or the womb, and even to prevent its conception. The financial power of large, quasi-monop-

olistic, going concerns put into their hands lethal weapons against parvenus who were likely, in a fight, to succumb without having done serious damage to their gigantic opponents.

The result of this corporate development has been a marked dampening, or perversion, of the spirit of enterprise. The limitation of liability to the amount subscribed to the stock of a corporation, and the possibility of spreading the risk widely, were, no doubt, factors strongly encouraging to enterprise and worthy of preservation.<sup>12</sup> But the concentration of power, far beyond the requirements of technological efficiency, has been highly deleterious, inasmuch as freedom of entry into various fields has been greatly curtailed. The inherent risk of loss in business has been artificially enhanced for new enterprisers and, instead of an uncertainty of success, which they would have been ready to meet, they were typically faced with the practical certainty of failure. Failure meant the loss of the great resources requisite to competition in industries where the advance of technology made very heavy investments a necessary condition of efficiency. The most that competitors could normally hope was that they might be able to establish for themselves a nuisance value which would lead an established company to buy them out, or permit them to operate as a docile and not inconvenient satellite of the leading concern. As one perhaps not very naive business leader remarked, after an agreement along such lines had been effected, "competition is now being carried on in a fine spirit of cooperation." The high profits that a moderately efficient or even a grossly inefficient quasi- or fully-monopolistic enterprise could command might do little, under such circumstances, to attract real and persistent competition.

Just as the action of dominating and domineering corporations shuts off enterprise on the part of potential competitors, so their more or less complete monopoloidal power operates to eliminate the necessity for any high degree of enterprise on their own part. They may, it is true, give the appearance of enterprise. Much has been made, for instance, of the elaborate organizations for re-

<sup>12</sup> The corporate form of enterprise offered the following additional advantages: (1) easy aggregation of the large capital necessary to many modern enterprises; (2) an immortality which facilitated the assumption of enterprise the fruits of which could not be reaped except over very long periods; (3) access by men of small means to business projects of indefinitely great scope.

search maintained by many of the great business corporations. These are all to the good, but they do very little to promote enterprise in the functional sense of that term as the assumption of risky responsibility. The large corporations do not take great chances in putting new or improved goods on the market. On the contrary they tend to engross inventions, and to retard their appearance, until it is all but certain that the new product can be successfully marketed even under depressed general economic conditions.<sup>13</sup> This is very far from providing an adequate degree of enterprise. The large corporation is, in any event, not well adapted to new enterprise. The flexibility requisite for and in new ventures is lacking. Quick decisions are difficult; new proposals have to run a gauntlet of critical investigation by ubiquitous vice-presidents; red tape is prevalent. A new and comparatively small concern, under owner-management, would ordinarily be a much better medium for the launching of innovations.

The evolution of the corporation not only restricted the enthusiasm for productive enterprise but made it easier for enterprisers to pursue a purely business, rather than an economic, course. Only under the freest competition, with no opportunity for the exertion of any other than productive power, do business and economics coincide. Where such competition is impaired, business and economics have little in common and, indeed, are frequently antithetical. Good business requires the exertion of every sort of power, socially beneficent or otherwise, which, in the existing milieu, will be condoned. Those who fail to exert all of such power as they can summon are not likely to achieve business success. Adam Smith long ago remarked that "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."<sup>14</sup> The all but inevitable aim of any enterpriser is to secure some type of monopoly, either as a buyer of his materials or as a seller of his output, or both, under which he can exert power, derived from something other than his productive efficiency, and

<sup>13</sup> The patent laws in this country have facilitated this dog-in-the-manger attitude. The German patent laws take much better care of the social interest in getting prompt production under new patents.

<sup>14</sup> *The Wealth of Nations*, Cannan Edition (The Modern Library, Random House, Inc., New York, 1937), p. 128.

command corresponding profits. The ideal situation, from the entrepreneurial point of view, is that of a strategically placed middleman, buying, as a monopolist, the product of competing producers whom his monopoly permits him to gouge and, also as a monopolist, selling that product, perhaps after processing, to competing buyers, either retailers or consumers, whom he can subject to similar exploitation. Such an ideal situation is, of course, seldom attained in full perfection but more or less remote approximations to it permeate the business world. Quasi-monopolies are established by advertising; by differentiation, through trade-marks, branding, and packaging, of products which are, in fact, identical with undifferentiated stock; by mere size and the good repute which, rightly or wrongly, goes with magnitude; by the exercise of financial strength in price "wars"; and by innumerable other devices generally subsumed under the head of unfair, i.e. unfree, competition. Any eminence attained in these ways permits of profits regardless of productivity and enables the "enterpriser," in *some* degree at least, safely to indulge a relaxation of the effort to improve his productive, as contrasted with his business, efficiency.

This process which, of course, operates in injury of the social interest can be checked only by a government alert to preserve, or establish, the conditions of free competition. It has, however, been greatly furthered, rather than checked, by the development of the corporation in the forms which, through legislative laxity, have been arrogated, and by the development of pecuniary success, as the sole criterion of business efficiency, within a monetary system which has fostered restrictions rather than an expansion of productivity.

The matter cannot be better summed up than in Thorstein Veblen's appraisal of American business enterprise in a note to his *Imperial Germany and the Industrial Revolution*.<sup>15</sup>

"In public speech much is made of the unlimited possibilities of this country, and of the utter freedom, boldness and assiduity of its enterprising captains of industry. It is true, these encomiums come most commonly and most volubly from among the members of the craft, but they are after all so integral an article of the popular faith that any question of them becomes an ungrateful if not

<sup>15</sup> (The Viking Press, New York, new edition, 1939), pp. 332ff. (Excerpt reprinted by permission of the Viking Press.)

an odious heresy. It will accordingly be more to the point to recite the circumstances of the case than to add fruitless asseverations.

"There need be no deduction allowed on the count of America's unlimited opportunities for profitable business enterprise. Within the circle of industrial countries the material resources of the country may well be admitted to have no counterpart; and its working population is also to be rated as of unexceptionable quality. But accepting these premises, the industrial outcome should logically be something quite unexampled, rather than second best.

"In respect of its business community America is the country of the self-made man; such was the state of the case unqualifiedly in that brief past when current business traditions took on what consistency they have, and such is still the state of the case as touches not less than nine-tenths of the volume of traffic or of the personnel. While one does not lightly lay profane hands on this palladium of the republic, it seems unavoidable in this connection to inquire somewhat into the current process of production of this self-made man, and so into his bearing on the state of enterprise in the business community.

"The raw material out of which he is made is substantially the same as that which goes to make the American politician, and the arts of production employed and serviceable are also much the same in both cases. As is true of most native Americans, he comes from the farm, in the sense that he has commonly been born outside the limits of any properly urban community; but he will commonly have left the farm for the country town in boyhood. It is in the country towns, and in the smaller cities, so-called, that far and away the greater number of American business men have their beginnings; and the greater number of them, indeed, spend their later life and endeavors in the same surroundings. Success in these surroundings becomes the test of fitness to do business, or to be trusted with discretion in business aside from or beyond these surroundings. For all but a vanishing minority, it is these country-town circumstances that selectively decide whether a given candidate for self-made business enterprise is fit to survive. So that the great proportion of those who have the country's business, and therefore its industry, in hand are those who have proved their fitness for survival under the conditions imposed by the country town, or by the small city, which is an overgrown town.



"The American country town, and the small city in its degree, is a peculiar institution, little appreciated by observers from oversea. It is a business community; that is to say it lives for and by business traffic, primarily of a merchandising sort. It is often spoken of as a center or sub-center for the distribution of goods to the country population, and for the receipt and transmission of country produce; but this is definition by enumeration of mechanical facts only. The reason of its being is the gain to be got by doing business in this particular place. The nucleus of its population is the local business men, whose interests constitute its municipal policy and control its municipal administration. These local business men are such as the local bankers, merchants of many kinds and degrees, real-estate promoters, local lawyers, local clergymen. In the typical town all these have something of a hand in municipal politics, which is conducted as in some sort a public or overt extension of that private or covert organisation of local interests that watches over the joint pecuniary benefit of the local business men. It is a means of rewarding serviceable local politicians with salaries and perquisites, especially the latter, and of safeguarding the local business community against interlopers and against any evasive tactics on the part of the country population that serves as host to this businesslike growth. This politico-pecuniary enterprise in municipal policy and perquisites is a case of joint action rather than of collective action, since each and several of the participants, overt and covert, takes part as strategist or diplomatic agent for his own pecuniary interest. . . .

"The number of self-made men that have emerged from this traffic . . . has been very considerable. So considerable, indeed, as still to give its distinctive character to the American business community at large, in spite of an increasing contingent, especially of younger men, drawn from other sources and different antecedents. There is consequently enough of a country-town animus pervading this community selectively to bring any recruits from other breeding-grounds into conformity with these country-town ideals of what is the suitable conservative temper that a man should possess in order to be trusted to do business.

"The successful man under this state of things succeeds because he is by native gift or by training suited to this situation of petty intrigue and nugatory subtleties. To survive, in the business sense

of the word, he must prove himself a serviceable member of this gild of municipal diplomats who patiently wait on the chance of getting something for nothing; and he can enter this gild of waiters on the still-born increase, only through such apprenticeship as will prove his fitness. To be acceptable he must be reliable, conciliatory, conservative, secretive, patient and prehensile. The capacities that make the outcome and that characterise this gild of self-made business men are cupidity, prudence, and chicane—the greatest of these, and the one that chiefly gives its tone to this business life, is prudence. And indispensable among the qualities that command that confidence of his associates without which no man can make himself as a business man, is a conservative temper.

“The ways and means to the making of the self-made man in American business are of this character, and the product is of such a quality as these ways and means may be expected to yield, acting as they do with great uniformity both by training and by selection. It by no means follows that either the business men created by this means, or the business community built out of this select and carefully seasoned material, lacks enterprise of a sort. But it is enterprise in the way of pecuniary strategy, in the getting of something for nothing by shrewd management of pecuniary values. It is enterprise of the kind that eschews innovation. Adventures in new, untried, unstandardised industrial projects and expedients are alien and anathema to the prudent, conservative business community. It is only after such excursions have proved their pecuniary gainfulness in spite of the business community’s astute incredulity, that they come to be taken over as a source of gain. But in expeditiously intercepting the gain derivable from such industrial innovations as have proved their gainfulness in spite of the incredulity of the business men, or from the usufruct of such resources as are known to lend themselves to the standard methods of pecuniary manipulation, this business community shows a high degree of efficiency.

“America is the land of unlimited possibilities, it is believed, both in respect of material resources and in respect of inventive genius. But it is a notorious commonplace that the mechanical inventions which have in a sense made America what it is in the industrial respect have not only not been made by the business men—they are

astute and conservative pecuniary strategists, with neither insight nor aptitude in technological matters—but have also not been made with their support.

“It is worth noting that the country-town method of selecting and training the community’s business men, in that it makes its selection on grounds of astuteness, caution and cupidity, at the same time and by the same tests rejects such candidates as are endowed with technological insight or an aggressive curiosity in matters of industrial innovation. And connected with this selective bidding up of pecuniary astuteness and quietism is the well-known inefficiency of business management in American industry—well-known among men competent to speak on these matters, though not well credited among the business men at large, who commonly lack even the degree of technological insight necessary to appreciate the pecuniary loss involved in their own astute mismanagement. The ‘efficiency engineers’ have no hesitation about saying that the business men’s management of industry has resulted in a wasteful use of the equipment and labor employed, sometimes rising to figures fairly incredible to the common layman.<sup>16</sup> This waste may be more or less, but it is a systematic result of the management of industrial enterprise by the self-made business man. At the same time the efficiency engineers’ criticism takes no account of the waste involved in downright unemployment or stoppage of workmen and plant, due to the pecuniary strategy of the same conservative business men, although this item of waste doubtless exceeds by several fold that caused by incompetent management while the plant is running.

“Something is always to be allowed for exceptions and side issues in any generalisation so broad as this, and the broad proposition just set down in characterisation of the American business man is not to be taken as applying without such qualification. But when all desired qualifications have been allowed there remains this unflattering state of the facts, notorious and comprehensive: America has unrivalled material resources and a working popula-

<sup>16</sup> (*Note by the present writer*) The essence of the conflict between the engineers, as a group, and the financiers, as a group, is that the engineers seek to destroy the *status quo* in technology, and supplant it with something better, while the financiers seek to preserve the technological *status quo* so that obsolescent equipment and sites will still be able to produce profits for their account.

tion nowise inferior to any other for industry under the machine technology; American business men have had a free hand and a minimum of burdens in the way of taxes or other government exactions . . . [but] the American achievement in this field within the same period has been notoriously less conspicuous and less substantial, e.g., than that of Germany since the formation of the Empire. Nowhere have the business men had so full and large a discretion, nowhere have they been favored by government regulations to the same extent—for the reason that nowhere have they controlled the making and administration of the laws in anything like the same degree; and nowhere have they fallen short of their opportunities by so wide a margin.

“It is true, there is much said of American boldness and resourcefulness in business enterprise; and there is some substance to this boast in so far as ‘business enterprise’ is taken as a synonym for ‘pecuniary intrigue,’ also called finance. But if it is to be taken in any more substantial sense it is useful only as evidence that men like to be flattered by imputation of virtues which they do not possess. The country-town self-made man is not the only kind comprised in the American business community, nor is the self-made man’s country-town spirit of conservative chicane the whole scope and method of business in this community; but he is far and away the most numerous species of business man in this community; and he has been so by tradition so long and consistently that business usages, relations and ideals in this community have been conventionalised on his lines; so that by force of conventions, in good part embodied in law, and by force of the like spirit in an effective majority of the living generation, it comes about that this country-town conservative chicane is accepted as the type of safe and sane business enterprise.

“Even the larger business finance and the larger American business financiers accordingly still show the earmarks of this country-town derivation—not that these individuals who hold the industrial fortunes of the country in their hands have therefore individually come up through the country town to their later stations of responsibility, but only that the authentic conceptions of business methods and animus, to which all safe and sane business men must conform, are of this derivation, and that therefore the business

community at large will do business only on this footing. American business is eminently of a financial character, and the traffic of these financiers runs within the closed circuit of money-market strategy, with any industrial effects of this financial management coming in as incidentals. The controlling incentives are those of the market for securities, not those of the output of goods; and the final discretion vests in the investment banker, not in the engineering staff or the manager of the works. The discretionary direction of affairs has in effect passed into the hands of these financiering houses, whose ostensible relation to the industrial concerns is that of underwriters only. While these financiers exercise the discretion, they have no responsibility for the conduct of the industries dependent on their discretion."<sup>17</sup>

Proficiency in the art of sitting on strong boxes, whether in the political or economic world, is, of course, no developer of power. As the sitter grows flabby the chance of even maintaining his ten, five, or two talents, to say nothing of increasing them, becomes progressively less. The corporation, as such, was by no means uniquely responsible for the decline in this country of the enthusiasm for productive, as compared with merely business or financial, enterprise, or even for the growth of that monopoloidal character of modern business concerns which made for more or less protracted *business* success despite the spread of the stealthy and pervasive atrophy of the most essential economic virtues. The undue extension, and abuse, of the corporate privilege, however, was a prime factor in the outcome. It was a change in the law that opened the way for the subversive evolution of the corporation, from subject to sovereign, and what the law has given it is not without the power to modify to the extent deemed expedient. A corporate franchise is a valuable special privilege the granting of which should be rigorously circumscribed in the social interest and for which there should be a recurrent charge equivalent to its continuing value.

<sup>17</sup> Veblen's remedy for the frustration of industry by finance was to put the engineers into absolute control of the economic equipment of the community. How this was to be done he did not say but it seems certain, in any event, that it would simply convert the engineers into (hypertrophied) businessmen and subject the community to whatever tyranny seemed good to them. The way of salvation lies not along this path.

## REFORM OF CORPORATE STRUCTURE

The following program of reform of the corporate business structure, suggested by Professor Henry C. Simons, is the minimum requisite for effective social control of the corporate privilege:<sup>18</sup>

- I. Transfer to the federal government of the exclusive power to charter ordinary, private corporations, and subsequent annulment of all charters granted by the states.
- II. Enactment of federal incorporation laws, including among others the following provisions:
  1. That no corporation which engages in the manufacture or merchandising of commodities or services shall own any securities of any other such corporation
  2. Limitation upon the total amount of property which any single corporation may own
    - a. A general limitation for all corporations, *and*
    - b. A limitation designed to preclude the existence in any industry of a single company large enough to dominate that industry—the principle being stated in legislation, the actual maxima for different industries to be fixed by the Federal Trade Commission
  3. That corporations may issue securities only in a small number of simple forms prescribed by law, and that no single corporation may employ more than two (or three) of the different forms
  4. Incorporation of investment corporations under separate laws, designed to preclude their becoming holding companies or agencies of monopoly control—with limitations on their total property, on percentage holdings of securities of any single operating company, and on total investment in any single industry (again under the immediate control of the Federal Trade Commission)
  5. That investment corporations shall hold stock in operating companies without voting rights, and shall be prohibited from exercising influence over such companies with respect to management

<sup>18</sup> *A Positive Program for Laissez-Faire*. (The University of Chicago Press, Chicago, 1934), pp. 19-20. (Reprinted by permission of the University of Chicago Press.)

6. That no person shall serve as an officer in any two corporations in the same line of business, and that no officer of an investment corporation shall serve as an officer in any operating company
7. That corporate earnings shall be taxed to shareholders in such a manner as to prevent evasion of personal-income tax with respect to undistributed earnings.

#### SUPPLEMENTAL MEASURES

This program, almost entirely restrictive, should be supplemented by positive measures of encouragement to new and smaller concerns. The initiation of an enterprise, whether in a virgin or an already ploughed field, is normally attended with greater risk than is associated with the maintenance of a going concern. The large profits occasionally made by new businesses are the counterpart of the high risk of loss which is assumed in the undertaking. Such profits are necessary to the maintenance of an enthusiasm for enterprise. A system of taxation which does not discriminate between profits so earned and profits that are the result of an established monopoloidal position is certain to diminish competition and reduce the disposition to initiate new ventures. It would, therefore, seem desirable to remit entirely the taxation of the profits of new, independent, and still small, concerns, the burden of proof being on the concern to show that it is not merely an affiliate of a large and well established corporation.

This would not only be a stimulus to enterprise but would be a recognition that size, as such, when it reaches the point of giving a measure of control of the market, is socially objectionable. "It is sometimes asserted that the mere size of a corporation should not affect its standing before the law, or its rights and obligations. In the sense in which this assertion is probably intended, it is correct; but if it is intended to imply that a corporation requires no more legal control when it is large than when it is small, it is untrue. The larger the corporation, the greater is its power . . . and this makes it especially important that its power be under control. . . . [There is] no support to the view that the mere bigness of a corporation is not a matter for the law to take into account. . . . This does not mean that large corporations have worse dispositions than small, nor that their members are meaner men than the members of

small corporations. It only means that the disproportion between power and responsibility increases with the size of the corporation. . . ."<sup>19</sup>

"If, without the slightest change of character or disposition . . . [the common house cat] were suddenly enlarged to the dimensions of a tiger, we should at least want her to be muzzled and to have her claws trimmed, whereas if she were to assume the dimensions of a mastodon, I doubt if any of us would want to live in the same house with her. And it would be useless to argue that her nature had not changed, that she was just as amiable as ever, and no more carnivorous than she always had been. Nor would it convince us to be told that her productivity had greatly increased and that she could now catch more mice in a minute than she formerly could in a week. We should be afraid . . . that in her large-scale mouse-catching she might not always discriminate between us and mice. . . ."

<sup>19</sup> Thomas Nixon Carver, *Essays in Social Justice* (Harvard University Press, Cambridge, Mass., 1915), pp. 328ff. (Reprinted by permission of the President and Fellows of Harvard College.)

Professor Carver lays great stress on the coincidence of a progressive decline in the responsibility of the officers with a growth in the size of their corporation. He points out that the officers of a large corporation are handling the money of other people rather than their own. This is a standing invitation to extravagance and corruption. The impersonal character of the corporation, he says, tends to destroy any feeling of responsibility, on the part of shareholders and officers alike, for the acts of the corporation. This is always and everywhere a dangerous moral situation. The difference between a moral being and a monster is precisely this: the moral being feels a sense of responsibility, but the monster feels none. The combination of great power with a lack of responsibility has produced the worst crimes of history. The only remedy, of course, is to fix on individuals the consequences of their acts.

Needless to say, it is not here alleged that egregious abuse of other people's money by officers of corporations is typical, but merely that it is not infrequent, and that there are many real abuses which tradition has sanctified. The typical officer of a corporation is much too prudent to indulge any temptation to divert corporate funds to uses which the prevailing business morality would not condone and, in most cases no doubt, he does not even feel any such temptation. But he has no hesitation in voting to himself a salary and bonuses which he would be most unlikely to be able to extract from a situation of perfectly free competition. His prudence, moreover, precludes a quite legitimate employment of corporate funds in such adventurous enterprise as might better quadrate with the desires of the general body of stockholders than does the payment of large salaries for routine management. The evolution of the corporate directorate into a practically self-perpetuating and uncontrolled "agent" of the ostensible enterprisers (the stockholders) has done much to deprive enterprise of any driving force.



"The enormous power which goes with the mere size of the corporation, combined with the lack of responsibility which members feel for its acts, makes the corporation a monster which needs the most careful and rigid control."<sup>20</sup>

There is reason to doubt the net productivity of mastodonic concerns—they are likely to eat more than they produce—but the preservation of freedom requires, in any event, that they be held in check. Perhaps the best means is the conscious fostering of the competition of smaller concerns even if, as is doubtful, this might imply some loss of "efficiency." Prevention is to be preferred to cure and the ultimate measure of necessary control will be much less if small concerns take some business away from the great, and thus keep them from growing greater, than would be requisite to the preservation of freedom if matters were allowed to take their course.

The basic reason for productive units as small as is consistent with a tolerable efficiency is to remove any incentive to restrict production and to keep out of private hands both the power to exploit the community at large and the power, in the perpetrator of restrictive practices, not only to ward off disaster to himself but even to extract advantage from such activity. Free competition, in a word, is a *plan* of economic institutions under which the powerful urge of self-interest is deprived of deleterious social effects and the industrial machine, of its own inner compulsion, works automatically in socially salutary fashion. This, however, is not the sum of the matter. Responsibility is the great developer of men, and the larger the number of independent, competitive, enterprisers the greater is the opportunity to self-reliant men to bring to flower the talents they possess. The milieu for a wide variety of expression of talents is essential to the development of a fully matured social power. In a diversified entrepreneurial situation, with specialization in small units carried far, every strong personality will have an opportunity to acquire what to him is the *summum bonum*, a place of his own creation in which to exert his powers in freedom and to the full. Business concerns, therefore, should never, at most, be larger than is necessary to the attainment of productive (not selling) efficiency. The maintenance of as free competition as can anyhow be attained is the appropriate regulator to this end.

<sup>20</sup> *ibid.*, pp. 332, 328.

Where, on technological or other grounds, it is impossible to preserve free competition without an intolerable sacrifice of productive efficiency (social power) a question arises as to the best means of regulation to prevent that inequity in the distribution of production which always attends the possession of any degree of private monopoly.

"Of all the ways of handling monopolies . . . the method of leaving the management in the hands of private enterprise to be run for profit and then setting up a public authority to regulate the private enterprise would seem to be the worst. . . . The combination of private management for profit with public boards to determine allowable prices and profits makes for inflexibility, rigidity, and duplication of effort. It invites corruption of government by creating a situation in which the profits of the private owners depend as much upon their ability to influence the regulating authority as upon other considerations. Executive talent is diverted from the task of organizing efficient production to the task of influencing 'public relations.' The costs are paid by the public. The regulating authority, on its side, can do little but obstruct."<sup>21</sup>

In his pamphlet *A Positive Program for Laissez-Faire*, already cited, Professor Henry C. Simons says:

"Public regulation of private monopoly would seem to be, at best, an anomalous arrangement, tolerable only as a temporary expedient. Half-hearted, sporadic, principle-less regulation is a misfortune for all concerned; and systematic regulation, on the basis of any definite and adequate principle, would leave private ownership almost without a significant function or responsibility to discharge. Analysis of the problem, and examination of experi-

<sup>21</sup> Eugene Staley (*World Economy in Transition*, Council on Foreign Relations, New York, 1939), pp. 186-187. Where public utilities are *guaranteed* a return, as is at present not far from being the case, the chief argument for private enterprise, viz., the disposition of risk on a voluntary basis, falls to the ground. And where, as in most public utilities, management is largely a matter of routine, the public utility "enterpriser" performs almost none of the typical functions of that factor of production. With a return guaranteed, and therefore no risk, the rate on actually invested pecuniary capital should not exceed that on prime government bonds, and the attractiveness of private ownership of the utilities would then cease. If, however, private ownership, in any form, is retained, every device in stimulus of productive efficiency, rather than cajolery, in the management, should be developed. The private enterprisers in public utilities might, for instance, be granted increased returns in proportion, as costs were lowered by efficient management.

ence to date, would seem to indicate the wisdom of abandoning the existing scheme of things with respect to the railroads and utilities, rather than of extending the system to include other industries as well. Political control of utility charges is imperative, to be sure, for competition simply cannot function effectively as an agency of control. We may endure regulation for a time, on the dubious assumption that governments are more nearly competent to regulate than to operate. *In general, however, the state should face the necessity of actually taking over, owning, and managing directly, both the railroads and utilities, and all other industries in which it is impossible to maintain effectively competitive conditions.* For industries other than the utilities, there still remains a real alternative to socialization, namely, the establishment and preservation of competition as the regulative agency.<sup>22</sup>

It should be noted that monopoly, *as such*, is not reprehensible since it may, in certain cases, be the sole means of attaining productive efficiency. It is *private* monopoly to which objection must be taken on the ground that it confers private power, quite unassociated with socially beneficial performance, which will, with practical certainty, be used to exploit the vast majority who do not share in it. Where an industrial monopoly is inevitable because free competition cannot be maintained at all, or does not work satisfactorily, the obvious recourse is to turn the private into a social monopoly to be operated for the general welfare.

#### NECESSITY FOR STIMULATION OF EFFECTIVE DEMAND

Even granting, however, that, with appropriate corporate reform, effective competition in the greater part of the economy would prevail so far as is essential to equity in the distribution of income, there is still an important and inevitable respect in which the existence of large-scale enterprise, with consequent oligopolistic markets, places limitations upon the dynamics of the competitive economy as a whole. It is at this point that orthodox economics, conceived within the framework of *pure* competition, is most in need of amendment.

<sup>22</sup> *op. cit.*, pp. 11-12. The test of the social worth of all business corporations lies in the answer to the question as to whether such power as they have is productive power only. If not, they should either be shorn of their non-economic power or taken over by the public. Yardstick competition may, in many cases, be the best test of the *productive* efficiency of the concerns for which it serves as a measurer.

The rationale of the orthodox belief lay in a wholehearted acceptance of Say's law that supply and demand are synonymous. History has dealt rather severely with this so-called law, and the Achilles heel of the modern economy is the fact that in oligopolistic markets it does not hold. The essential features of such markets are that: (1) costs are rigid or at best sticky; (2) costs depend on output and therefore on the volume of orders; and (3) no individual producer may ignore the effect of his output on market price. A fall in the general price-level, which in a *purely* competitive economy might result merely in a downward revision of costs without any significant change in total output, will, in a system of oligopolistic markets, precipitate a marked contraction in production and employment. The same result may occur, without any preliminary drop in the price level, if effective demand, for any reason, falters.

Orthodox economists, when confronted with this situation, are likely to decry the existence of inflexible costs and to suggest a direct attack upon them. Since wages are usually an important cost and, on the whole, the easiest to manipulate, the attack is centered upon this element in the structure. The expedient of reducing wages may possibly succeed in stimulating employment and output wherever wages are the major factor in costs and enterprisers are optimistic over the prospects arising from their reduction, but, as earlier pointed out, it is perhaps rather more likely to cause a further unsettling of the economy and to issue in a progressive deterioration in output.

The difficulty with the cost-reduction approach to the problem of deflation (either of prices or production or both) is that it attempts to attack maladjustment with a system of principles which presuppose an institutional framework quite alien to that which in fact exists. The simple truth is that the very conditions of production imposed by modern technology call for stable, nearly rigid, costs in the short run. Many sticky cost-price relationships, which are loosely referred to as pernicious rigidities, are, when viewed functionally, but the obverse of stable business conditions.

#### INEVITABLE FIXATION OF COSTS

Large-scale production requires planning, by business concerns, over considerable periods of time. In order that such plans may be

made with efficiency, and with some assurance of success, some of the variables in the picture must, for the period concerned, be eliminated. Without the fixing of most costs the executive problem in large-scale production would exceed manageable dimensions. A *perfectly* competitive world would require an enterpriser to enter the market daily and contract anew for his physical plant, site of operation, working capital, labor, and materials. Under existing techniques of production the result of such a process, were it even possible, would be nothing short of chaos. In the short run which, with the processes now employed, may be a period of several years, so large a proportion of costs is, in the nature of the case, fixed, that a rapid and substantial downward adjustment in the total is out of the question. The existence of a sticky cost structure must, therefore, be accepted as an inevitable feature of the typical modern productive unit. To hope for an automatic flexibility in the cost structure, to correspond to whatever changes may occur in an arbitrarily fluctuating price level, is to indulge in wishful thinking, while to attempt to *force* adjustments, in a still partially free economy, would provoke dissolution.

#### STABILITY IN THE PRICE LEVEL A REQUISITE

Since money costs are inevitably sticky, the only reasonable approach to the maintenance of appropriate price-cost relationships is to put some stability into the general price level. Owing, however, to the dependence of costs on the volume of output, and the fact that an individual oligopolistic concern can expand output only through a cut in price which it may not be able to support, price level stability is not a sufficient condition to provide an oligopolistic economy with a continuous impetus powerful enough to assure continuous full employment. The stable price level must, therefore, be supplemented with a general stability in demand<sup>28</sup>—a substitute in the oligopolistic market for the infinitely elastic demand faced by the individual competitor in a *purely* competitive market. The necessity for this stimulus is the greater by reason of the decline in the spirit of enterprise associated with large-scale corporate business organization. Given the two conditions of price level stability, and stability of demand, however, the oligopolistic

<sup>28</sup> It is, in fact, improbable that a stable price level could be maintained without a corresponding stability in demand.

economy would be able to maintain full employment, with a progressive cutting of costs and increase of wages, as technology is improved. There seems, in fact, to be no a priori reason why, under these conditions, the modern economy, despite its oligopolistic character, should not partake of the fluidity of a purely competitive structure in the degree necessary to the play of free enterprise and free choice. Free entry must also be preserved. When a continuous effective demand is provided, in the manner suggested in Chapter V, entry into any enterprise will be much less obstructed than it now is and the only difficulties which might issue out of oligopoly are those of the allocation of resources and the distribution of income. Unless oligopolies disappear through merger into a private monopoly, the problems of allocation of resources and distribution of income will not, however, be of major import if those existing monopolies which, for technological or other reasons, are inevitable, be brought under governmental control.

Perfection can readily become the enemy of the pragmatically best and the search for absolutes in competition, as elsewhere, is doomed to disappointment. If, then, we get a degree of competition which works for the release of power, and for the distribution of its fruits in substantially equitable fashion, we may, for the time being at least, forgo the pursuit of perfection.

## CHAPTER XI

### TAXATION

**T**AXATION, its absolute amount, its distribution, and its forms, focuses within a narrow compass most of the vexing questions of the relationship of the individual to the group, of the rights of individuals vis-à-vis one another, and of the rights of minorities against the majority. It may influence, in any degree, the allocation of income. If all decisions as to taxation and public finance could be made unanimous, the mechanics of taxation, the portion of the total income to be spent collectively, and the allocation of the tax burden, would be determined in a manner comparable to that in which individual free choice in the private economy makes for the optimum use of the individual income. Specific social decisions, however, are seldom conceived with a single "public mind"; on the contrary, they represent a compromise of views. Many policies must of necessity be promulgated, by a larger or smaller majority, without significant concessions to the views of minority groups. Social policies, including taxation, inevitably cut across many individual and group interests and require at least an implicit element of coercion.

#### TAXATION THE FOCUS OF CONSTITUTIONAL HISTORY

All questions of justice in taxation arise out of these conflicts of interest. In the time-worn but still relevant phrase, "the power to tax is the power to destroy." Taxation has therefore been the occasion for the most stubborn contests over political and social rights. The struggle has been unceasing and often sanguinary. The evolution of the British constitution, for example, from Magna Carta down, has been characterized by persistent conflict, between king and nobles, landlords and enterprisers, the nobility and the commoner, over the control of the public purse. And, in this country, it need hardly be recalled that the Revolution was ushered in with the cry of "No taxation without representation!" These examples of the social struggle associated with public finance might be endlessly supplemented, but it will suffice to say that the power to tax, next to the power of the state to exert physical force, is the most potent instrument of collective action. Under circumstances in which disproportionate political and economic power has been

permitted to develop, Professor T. S. Adams was probably not far wrong in asserting that class politics is of the essence of taxation.<sup>1</sup>

Typical governmental services are rendered indiscriminately and no imputation of services to the isolated individual is ordinarily possible. The individual is therefore required to pay taxes to finance services of which he personally may not approve and, in consequence, is compelled to "consume" services for which he may have no conscious need. The services, indeed, may have positive disutility for him. The impossibility of isolating the individual from the group precludes, with some exceptions, the allocation of costs according to services rendered. The whole problem of taxation policy must therefore be referred to the general social philosophy and any specific policy will be judged reasonable and equitable according to the social perspective.

#### THE GOVERNMENT'S SHARE OF INCOME

The question of the share of the total national income to be realized through the agency of government is a problem concerning which it is exceedingly difficult to lay down broad generalizations. On the one hand, it might be argued that, conceptually, no a priori limits should be placed on the area of governmental activity and that whether a service should be provided by a governmental or a private agency is purely a matter of efficiency or general expediency. On the other hand, since governmental action involves limitations on the free play of individual choice in the use of income, and requires consumption by majority decree, it might be maintained that all but quintessential governmental services should be forgone. The classical economists tended to regard all taxes as bad, and government as a necessary evil, while the collectivist view places emphasis on technical efficiency and conceives of "social action" as inherently superior to that of private individuals.

Certainly the Smithian doctrine that governmental service should be confined to the establishment and maintenance of public health and safety, narrowly construed, is much too limited a conception of the sphere in which governmental activity may be held to be socially advantageous. However skeptically one may view

<sup>1</sup> "Ideals and Idealism in Taxation," *American Economic Review*, vol. xviii, no. 1, March 1928, p. 1.



the growth of governmental outlay for allegedly social services, the idea that "the state can do no right" is naive, and could have arisen only as a reaction to oppressive interference. The notion that the best tax program is that which envisages the raising of a revenue sufficient only to provide minimum requirements of social stability and protection was conditioned by the antiquated doctrine of "productive" and "unproductive" expenditure. The classical conception of state expenditure, as a corollary of this doctrine, was that it reduced the rate of capital accumulation and diverted funds from probably, or possibly, "productive" use in private hands to certainly "unproductive" use in political hands. The belief, however, on which this conception rested, that services are of less economic value than physical goods, whether produced in the private economy or by government, is now, of course, universally discredited. In the last analysis, the test of the promotion of the general welfare, though vague, is the only one that may reasonably be applied to any specific governmental expenditure or to the expenditures of government as a whole.<sup>2</sup>

The fear of the state felt by the eighteenth century political economists—later brought to most striking expression in the writings of Herbert Spencer—was, nevertheless, based on bitter experience by no means confined to their own day. Spencer's work, however biased, is frequently surprisingly prophetic of the excesses of *étatisme* which mark the present era.

A plausible case can usually be made for any public outlay of funds on the ground that it is in the public interest—especially if pressure groups, in anticipation of future benefit to be derived from the legislation, are willing to provide funds for widespread propaganda. Not only have specific classes an exclusive interest in certain types of governmental services but the very agencies established to perform these functions develop an enthusiasm for their extension. Governmental bureaus can with comparative ease, and masses of more or less relevant data, demonstrate the allegedly indispensable nature of their services and the desirability of diverting additional funds in the same direction. This type of pressure is not, per se, reprehensible. It is largely a matter of professional

<sup>2</sup> Productive activity can only be defined as that which yields a net gain in social satisfactions. Maximum productivity is that which yields the largest social gain per unit of social cost. This may be an imprecise but yet a useful criterion.

pride, ambition, and self-esteem, on the part of the directors and personnel of governmental departments, and is a factor in the building up of departmental *esprit*. The extension of power, here as elsewhere, is a sign of life, but the life, unfortunately, is not ended with the development of cancer. On the whole, therefore, the ambition of public servants is not improbably maleficent.

All of this points to the conclusion that there is some merit in the persistent demand, from substantial taxpayers, that there be a lowering of governmental expenditures. It does not follow, of course, that restriction is always the best policy.<sup>3</sup> Governmental expenditure, like private expenditure, may be wise or foolish, and there is no certainty that less wisdom will be exercised in the one case than in the other. The presumption, however, on grounds of freedom, is against governmental spending. This presumption is rebuttable in specific cases but some checking, or reversal, of the strong trend toward flamboyance in the evolution of governmental services is a consummation devoutly to be desired.

#### DISTRIBUTION OF TAX BURDEN

The question of the *distribution* of the tax burden presents two allied problems, the problem of equity, and the problem of the effect of taxation on incentives.

Apart from the rule that persons in like circumstances should be treated equally it is difficult to speak of equity in taxation with much assurance. Tradition presents us with three alternative principles of equitable distribution: (1) the principle that the tax burden should be distributed according to the "cost of service" rendered each individual or, what probably amounts to the same thing, "the benefits received";<sup>4</sup> (2) the principle that it should be distributed according to "ability to pay"; and (3) the principle that taxation should leave the prior distribution of income unchanged.

<sup>3</sup> What is said here on the subject of governmental expenditure does not at all closely relate to the question of "deficit spending" for purposes of creating full employment. The problem of employment, as is pointed out in Chapter V, can be solved without deficits, by the expenditure of costlessly created money for salable goods to be released, in a counter exchange for the money, on the advent of any sign of inflation.

<sup>4</sup> "Cost of service" and "benefits received" are sometimes differentiated but the distinction, if any, is somewhat esoteric and is of slight, or no, relevance to the present purpose.

It has already been indicated that it is normally impossible to allocate the value or cost of the governmental services rendered to the individual. The "cost of service" principle may therefore be dismissed with but brief amplification. Probably the most obvious case of the impossibility of weighing the value of governmental service to the individual is in the preeminent matter of public order and safety. A legal system and police protection is the *sine qua non* of any stable society. Its value to most of the members of the society is all but infinite and it is futile to inquire what any single individual would stand to lose (or gain) apart from the stability so provided. This is obviously also the case with most services relating to public health and morals. Without further illustration the whole matter may be summed up by saying that, with any governmental service indispensable to the maintenance of social institutions, no individual attribution of the cost or value can be made. With some governmental functions, however, cost allocation to the individual is feasible. It is possible, for example, to charge the maintenance cost of highways to the users of motor vehicles, and this is, in many places, the prevailing practice. It is likewise feasible to charge for water, mechanical power, and other divisible and exclusively appropriable goods, on a benefit basis. These items, however, do not loom very large in the picture and it is generally true that no *quid pro quo* principle is applicable.

#### MEANING OF ABILITY TO PAY

To the idea that taxes should be levied according to "ability to pay," it is, however, almost as difficult to give precise meaning as to the notion that they should be levied according to benefits received. In endeavoring to give greater content to the concept of ability it is customary to analyze that idea in terms of "sacrifice" to the taxpayer. This involves the establishment of a criterion of subjective value—the measurement of utilities of income to individuals—and an inter-personal comparison of such utilities. Assuming, as is not true, that this could be done, ability to pay may be construed in terms of "equal sacrifice" or "minimum sacrifice." The principle of equal sacrifice requires that the burden of taxation should be allocated so as to make the hedonic cost of government services equal to all taxpaying citizens. The principle of minimum sacrifice,

on the other hand, requires that the burden be distributed so that the real cost may be as small as possible for the taxpayers as a whole.

On the assumptions of equal hedonic potentiality for all citizens and of the progressive decrease in the marginal utility of a unit of money income as total income increases—the postulates of orthodox welfare economics—both of these principles of “sacrifice” lead to a rate of taxation which becomes progressively greater as income increases. In the case of minimum sacrifice, indeed, there is the possibility of the complete exemption from taxation of perhaps a majority of the citizenry (depending on the distribution of income) and the placing of the whole tax burden on the recipients of the largest incomes. It is clear, moreover, that, if the hedonistic ethics of welfare economics be fully accepted, the principle of minimum sacrifice is the appropriate basis of policy. This is the position of Professor Pigou who asserts that “we know that the best scheme from a distributional point of view is one conforming to the canon of equi-marginal immediate sacrifice, modified by regard for the indirect consequences of high taxation upon the rich in checking capital accumulation, and on the poor in diminishing productive efficiency.”<sup>a</sup>

In its ultimate implications this doctrine means absolute equality of income. Pigou does not refrain from drawing this conclusion. “If,” he says, “we push further toward the concrete, it appears that a system of equi-marginal sacrifice fully carried out would involve lopping off the tops of all incomes above the minimum income and leaving everybody, after taxation, with equal incomes. If the amount of revenue required is not enough to absorb the whole of the surpluses above the minimum—if, in Edgeworth’s words, there is not enough taxation to go around—the logical procedure would be first to take for the government’s needs the tops of the highest incomes, and then to continue taxing middle grade incomes and giving bounties from the proceeds to the smallest incomes till a dead level of equality is attained.”<sup>a</sup> Comment on this thesis is, for the moment, postponed.

<sup>a</sup> A. C. Pigou, *A Study in Public Finance* (Macmillan and Company, Ltd., London, 1928), p. 92.

<sup>a</sup> *ibid.*, p. 76.

## THE LEAVE-THEM-AS-YOU-FIND-THEM PRINCIPLE

The third possible principle that may be utilized for the determination of the equitable allocation of the tax burden is the principle that taxes levied for general revenue purposes should, so far as possible, leave the existing distribution of income undisturbed, i.e. that taxation should be strictly proportional to individual income. The basic idea of the proportionate tax is simplicity itself, the concept of proportionality being intelligible even to the most untutored minds. Proportionality has other virtues, both in theory and in practice, which are admitted even by its foes. Part of its simplicity has implications for equity. The proportional tax thesis suggests that, in the absence of any possibility of attributing to each individual the value of the services rendered to him, it is socially expedient to proceed on the assumption "that the consumption of the general public services is proportional to the income of each citizen."<sup>7</sup> The impossibility of imputation is thus forthrightly faced and this saves endless and sterile probing into the realm of introspective psychology.

## PROGRESSIVE TAXATION AS A PALLIATIVE

The justification, on grounds of equity, of progression, rather than proportion, in taxation assumes that the distribution of income, before taxation, is inequitable. Supposing it is, the use of progressive taxation is an awkward, apologetic, and ineffective means of poulticing a sore in lieu of an attack on the disease from which it springs. If, on the other hand, the distribution of income, before taxation, were equitable, the use of the principle of progression would inject inequity into a situation from which it had hitherto been free. So far, then, as society develops institutions which make for an equitable distribution of income, there is no case for progressive taxation on the mere ground of ability to pay and certainly not on any other ground. The situation calls, rather, for the use of the principle of proportionality.<sup>8</sup>

<sup>7</sup> Antonio de Viti de Marco, *First Principles of Public Finance*, translated by E. P. Marget (Jonathan Cape, London, 1936), p. 116.

<sup>8</sup> Since the value of most governmental services to the individual members of a community cannot be accurately assessed, nor can one take or leave them as he will, it could with some reason be contended that the ideal principle of allocation of the burden of taxation is neither progression nor proportionality but uniformity, that is, that all members of the community should pay the same amount. When the

Throughout this book the so-called law of the diminishing marginal utility of units of general income has been treated with tender skepticism. The even more questionable psychological doctrine of equal hedonic potentiality for all individuals has been resolutely shunned. The ideal of pure equality of incomes, implicit in the orthodox hedonic assumptions, has been flatly rejected. An ethic which abstracts from the very varying conditions under which income is created or obtained, and deals, or attempts to deal, solely with subjective satisfactions derived from consumption, is not only open to objection on psychological as well as ethical grounds but presents a cleavage between a supposed ideal and the necessary conditions of its realization.<sup>9</sup>

Even those who most ardently subscribe to pure egalitarianism, on the basis of "equity," find that, on grounds of economy or production, their "ideal" must be warped out of all cognizability. Pigou, for example, after expounding the equi-marginal thesis at some length, ultimately discovers that, because of the influence of taxation on the level of efficiency and on the volume of saving, the principle of immediate minimum sacrifice must be abandoned. His final conclusion is that "the net result is that both poor people and rich people are less satisfactory subjects of taxation than they appear to be at first sight. The scale is tipped against the unfortunate intermediate class of moderately well-to-do persons."<sup>10</sup> Mr. Hugh

bulk of taxes was indirect—excises on consumption—this ideal was perhaps nearer realization than at present, and the taxes, moreover, were in part voluntarily rendered, since one could avoid them by refraining from the purchase of taxed commodities. Some writers refuse to consider as current income that part of receipts which an individual proceeds to save and, under excise taxes, this is of course exempt. So far as savings are socially urgent, the principle quadrates also with desirable incentives to social action. Whatever the logical validity of the principle of uniformity, however, it may at once be dismissed as out of the question when governmental expenditures have reached the levels which are now all but universal. To cover the expenditures of most states nowadays it would be necessary, under uniform taxation, to take the whole of the income of a not inconsiderable proportion of the population. Many would then come on the state for support, the uniform tax would then necessarily be increased with the result of putting more people in the same boat; a further jacking up of the uniform rate would follow, with further consequences of the same sort and so *ad absurdum*.

<sup>9</sup> The necessary obligations, to a family and otherwise, of any two taxpayers of equal income may vary in any degree. The two incomes, moreover, may have arisen from very different degrees of economic exertion, risk, and merit.

<sup>10</sup> *op. cit.*, p. 81.

Dalton, of the same "minimum sacrifice" school of thought, sums up his distributional discussion with the remark: "If, however, we look at the problem of the distribution of the burden of taxation from the point of view, not of equity but of economy, we stand on surer ground, though we may ultimately be led to conclusions less simple in form than those furnished by equity."<sup>11</sup>

The theory of equity advanced in the present analysis of social goals does not envisage equality of incomes. The ideal of equality espoused is, on the contrary, that of equality of opportunity. Taxation may be one of the instrumentalities for the implementation of this latter ideal, as it is in fact in the case of inheritances, but, apart from its value as a tool in creating the conditions of equality of opportunity, there would seem to be no justification for the use of progressive, that is to say discriminatory, taxation.<sup>12</sup>

Many of the proponents of steeply progressive taxation are not champions of equality of incomes. They advocate progressive taxation as a substitute for more basic institutional reforms and in acceptance of the fact that this must be a rather inequitable world at best. Some merit, as will presently appear, is to be attached to the latter consideration, but for the idea of taxation as a palliative for more general and basic reforms there should be no quarter.

#### PROPORTIONALITY IN TAXATION AND ECONOMIC INCENTIVES

The case for proportionality in taxation is further strengthened when we consider the effects of taxation on the incentives to produce, a question not to be divorced, in any practical sense, from the question of equity. The problem of motivation or incentives is

<sup>11</sup> *Principles of Public Finance* (Alfred A. Knopf, New York, 1923), p. 80. It should be noted that "equity," here, means equity as Dalton sees it.

<sup>12</sup> In the course of governmental expenditures, for the purpose of providing equality of opportunity, something akin to a moderate measure of progression in taxation may, of course, eventuate under a proportionate tax. A taxpayer with a large family, educated in the public schools, will receive more for his taxes than will he who has no children or, if he has children, educates them at his own expense. Per unit of benefit, a formally proportionate tax will then have some progressive incidence. Equality of opportunity, moreover, requires the provision by the state of medical service to those who would otherwise suffer in health, and, probably, subsidized housing for the very poor. Any (no doubt desirable) exemption of the lowest incomes from the operation of an otherwise proportionate tax would also bring on a degree of progression.

the crux of the economic problem as well as of most matters involving social relationships. The portent of taxation for economic incentives is no exception to the general rule. The individual reaction to taxation is largely governed by the elasticity of the individual demand for income in terms of the cost, in effort and sacrifice, necessary to obtain it. Since, in terms of effort cost, the individual's demand curve for income is probably a negatively inclined curve over most of its range, a limited measure of taxation might very well stimulate efficiency and strengthen the desire to work.<sup>13</sup> Persons with dependents, a desire to accumulate for old age, and a customary standard of living, might well feel the impulse to strive harder to meet an increase in taxation unless, indeed, the share of income to be taken by the state were so large as to destroy any prospect of realizing their economic plans or to make the struggle not worth while. It is likewise true that those motivated by the desire for conspicuous consumption might find added inducement to produce along with a limited increase in taxation. The probability that the demand curve for income is negatively inclined therefore lends support to both of the major ideas on public finance and taxation here advanced, viz., that the share of total income taken in taxes should be relatively small and that it should not be progressive with income.

There can, in any event, be little question that the prospect of paying over to the government a progressively larger fraction of successive increments of income, or of paying over a large fraction at all, is likely to be a deterrent on the individual motivation to produce and an inhibitor of enterprise. This is especially true of the more risky forms of enterprise which must be attended with a prospect of high profits if the strong chance of loss is not to kill off all enthusiasm for this socially desirable type of activity. If profits, when realized, are largely taxed away, while losses fall with undiminished weight on those whose projects do not "pan out," the spirit of enterprise which, on other scores is languishing, is not un-

<sup>13</sup> The *degree* of stimulation would depend upon the elasticity of the demand. If a tax should affect all brackets of income equally, the situation would differ markedly from that in which the higher brackets were subject to progressive rates. The *maximum* stimulus to effort would be that of a tax in which the highest brackets were subject to the lowest rates!



likely to vanish altogether.<sup>14</sup> In fact, as already suggested, it might well be beneficial to discriminate in favor of certain types of profit, as against other, income, with the intent of encouraging enthusiasm for enterprise.

The economic implications of proportionate taxation, so briefly discussed here, are summarized by De Viti de Marco as follows: ". . . proportional taxation is the fiscal system which respects to the utmost the production of wealth and capital accumulation. In fact: (a) it does not exercise, *per se*, any influence on the production of wealth, because it imposes the same burden—i.e. the same tax-rate—on each new unit of wealth produced, after deduction of expenditures of production; (b) it does not exercise any influence on the distribution of wealth, since it levies a uniform tax-rate on all incomes, and thus does not of itself create relatively more favorable terms of exchange either for those possessing small incomes or those possessing large ones; (c) in regard to the State budget, the proportional tax involves a single tax-rate, so that the ratio of total taxes to total national income is the same as the ratio of the taxes paid by each individual to his income, the tax having the exclusively fiscal aim of covering the financial needs of the State."<sup>15</sup>

So long as drastic inheritance taxes yielded heavily, most of the remainder of national public expenditures might be covered by a very moderate proportional income tax. If, however, as is likely, the practical confiscation of large estates should eventually reduce the present inequality in the distribution of wealth and income, and therefore the number of such estates, the tax-rate on incomes would rise. There would be some compensation for this, however, in the probability that the putting of property on the market, under the inheritance laws, would lower its capital value and therefore increase its yield. The comparatively young men, from whom enterprise is in general to be expected, are certain to be much more

<sup>14</sup> There would be a negative inducement to the assumption of a large risk of loss in any enterprise if, on a successful outcome, the whole income of the enterpriser were subject to highly progressive taxes which might leave him worse off than if he had remained quiescent. And, even if only the increment of income is subject to higher rates than apply to returns apart from the enterprise in question, the potential enterpriser might well hesitate before he would risk the loss of these returns along with such capital as he might put into the new enterprise.

<sup>15</sup> Antonio de Viti de Marco, *op. cit.*, pp. 186-187.

attracted to enterprise by the better prospect of immediate profits, out of which no large slice would be taken in income tax, than they would be repelled by the inability to pass on a still uncertain fortune at the presumptively remote date of their death.<sup>16</sup>

#### MODIFICATIONS OF THE PRINCIPLE OF PROPORTIONALITY

Having presented the case for proportionate taxation, however, it is necessary to modify it somewhat to take care of inevitable aberrations of income even where opportunity is made as equal as the facts of life permit. The *perfectly* competitive order is unattainable. There is certain to be an arbitrary element in the workings of free, as well as in those of bound, enterprise and, within fairly broad limits, fate, rather than merit, will distribute the prizes. It is likely that there will be a windfall or monopoloid factor in most large incomes. Equity, in the abstract, demands that these unmerited differentials in income be, so far as possible, eliminated.

The sources of windfall and monopoloid returns are manifold. Change in the value of credits and debts, as a result of inflation or deflation, is a classic historical example which we may hope will presently be relegated to the annals of the past. Shifts in real estate values following an unpredictable influx of population is another. As a more complicated modern illustration, we may take the salaries of movie stars. Each movie star has in a sense a monopoly of his or her own "talent." This talent, however, is the product in large measure of advertising and is illustrative of a form of product-differentiation or monopoloidal competition. The size of the salary, moreover, is in part conditioned by the size of the market, i.e. by the fact that films may be distributed throughout the nation, and even the world, whereas the audiences available to a much better actor on the "legitimate" stage are relatively small. The salary of the movie star is thus attributable to a technological change which gives a more or less permanent strategic position to those with photogenic qualities. While it would be possible to rationalize the sums paid to movie "talent," it seems likely that even the most confirmed believer in the justice of the market place would have some

<sup>16</sup> Levies on inheritances, moreover, are, as Bentham pointed out with respect to some of them, a peculiarly painless form of taxation, since, once they are regarded as irrevocable, nobody is deprived of anything he ever earned or disappointed at the failure to receive something he never had any reason to expect.

qualms about them.<sup>17</sup> Very similar to such incomes are the salaries paid to some executives of large corporations and the incomes received by fashionable lawyers or doctors. These incomes are in considerable measure attributable to strategic position or to the inevitable limitations on competition arising out of "bigness." The responsibilities of the recipients are, of course, great, and warrant corresponding remuneration; but some of the incomes, nevertheless, seem unconscionable.

It would be very convenient if all windfall and quasi-monopolistic elements in individual incomes could be segregated and taxed as such. This, however, is patently impossible and, in practice, it is necessary to adopt a rule of thumb with respect to the size of income and the probability that it contains windfall or monopoloidal elements. Two alternatives are open here: either to set an upper limit to incomes and take anything above that limit by confiscatory taxation, or to adopt a steeply progressive tax on incomes above a certain level. As it is impossible to ascertain whether any given large income is the reward of "merit" or is a windfall or monopoloidal return,<sup>18</sup> the latter of the alternatives would perhaps give the better approximation to equitable treatment though, on the other hand, it might result only in the payment of still higher salaries.

#### CONCLUSIONS

To summarize this brief analysis of the principles of taxation, we may note first that the idea of equity, in the sense of equality of opportunity, implies inequality in incomes. Assuming that the conditions of equality of opportunity obtain, the principle of progression in taxation is without warrant. Since it is impossible to allocate the tax burden on the basis of "cost of service" or "benefits received," any policy of distributing the tax burden must to a large extent be arbitrary and based on general considerations of social welfare. A system of taxation proportionate to income will, with

<sup>17</sup> The qualities that make a movie star, it is true, are often evanescent and the large incomes received may thus be regarded as a concentration within a few years of the earnings of a lifetime. There is nothing, however, to prevent a fallen star from shining in a new sphere.

<sup>18</sup> In some specific cases, of course, monopoloidal and windfall factors may be singled out and crudely weighed; in the short run, however, this is not likely to be possible.

some slight modifications, prove consonant with a policy of maintenance of an equality of opportunity, in part accomplished by practical confiscation of large inheritances. And finally, since government expenditure implies limitations on individual choice in the use of income, the restriction of governmental services to those areas in which private enterprise cannot efficiently operate to the ends desired is a canon of equity as well as of the larger freedom of which equity is part.



**PART IV • IMPLEMENTATION,  
REVIEW AND CONCLUSION**



## CHAPTER XII

### IMPLEMENTATION OF THE PROGRAM OF POWER-CUM-FREEDOM

SOCRATES, on being asked how to get to Mount Olympus, replied that the only way was to proceed steadily in that direction. With the direction defined, and the goal kept clearly in view, there is hope for progress even in the face of social inertia and of the obstruction of those to whom Olympus is not compellingly attractive. The measures for the release of economic power, proposed in Part II of this book, should prove much more easy of consummation than those, of Part III, for the distribution of the fruits of power along socially valid lines. In the one case the desirable action is chiefly prevented by timidity and confusion but, in the other, there is added to these the positive force of the self-interest of those who are concerned with the freedom of none but themselves and are eager for the preservation and extension of the privileges they now enjoy.<sup>1</sup>

The problem of the release of economic power is, in consequence, the obvious first point of attack. If this is cleared up, the problems of distribution will not only be less urgent but easier of solution. Much of the struggle over distribution arises out of the failure to maintain full productive power, and many of the difficulties which at present plague us would disappear if the fear of production were exorcised once and for all. Until, indeed, this prior problem is solved, everything else must result in social bafflement.

#### THE MEASURE OF CONFUSION

It would be naive, however, to take lightly the measure of confusion that must be overcome before policies of even wholly unalloyed benefit can be enacted. As one example of this confusion we may note the fact that, in all countries in which a modicum of freedom of opinion is retained, apprehension is now widely expressed over the eventual disappearance of the unlimited demand

<sup>1</sup> Tradition furnishes "valuable articles of ammunition . . . to let fly among men whom precedents serve instead of brains, who, knowing or caring little about what had best be done in future, will hear of nothing but what has been done before." Jeremy Bentham, *Deontology* (Longman, Rees, Orme, Browne, Green, and Longman, London, 1834), vol. 1, p. 57.



which prevails in time of war. Men are genuinely afraid that peace may at any time break out. The folly out of which this fear arises must be evident when we reflect that, at worst, we could go on producing war goods even when the need for them had been greatly reduced. To have less favorable economic conditions in peace than in war is, therefore, a prodigy of ineptitude. Yet there is grave danger that this prodigy will be brought to birth. Whatever else might be said of this, it would surely be a triumph in the confounding of confusion.<sup>2</sup>

To produce war goods for which we had small present or prospective use would, no doubt, be inane, but it would be wisdom itself as compared with having a large sector of the population, for an indefinitely lengthy period, producing nothing at all. The transition, after war, to the production of goods of which we would then have greater need could, under sane policies, be accomplished without unemployment beyond that incidental to a shifting of jobs. The essential condition is the provision of a persistent and unlimited demand for peacetime goods analogous to that which Mars imposes. The desires are there and, if they should ever cease, we should have no reason to worry over unemployment since it would then be voluntary. What is necessary is a reflection of these unlimited desires in unlimited demand. The economic machine stalls in peacetime, when demands are less continuously exigent than in war, because of shifts in the preference for liquidity and a consequent uneven flow of orders. The principle of the reservoir, which enables us to store and then use power which must otherwise go to waste, has at least as much importance in the field of economics as in physics. When we come to a recognition of this fact, and act accordingly, we shall be far on the way to elimination of one of the chief obstacles to freedom.

#### CAUSES OF CONFUSION

The confusion of thought in economic affairs arises partly from the complexity of the subject matter; partly from the fact that, unlike the physical sciences where a feasible isolation of phenomena makes controlled experimentation possible, there is no

<sup>2</sup> Even in the midst of a war boom the fear of a subsequent collapse is so strong that there is stubborn opposition, on the part of vested interests, to the installation, anywhere, of new, and needed, equipment.

automatic selection of sound ideas in the economic field; partly because, in a democracy at least, any economic proposal, however well conceived, must run a gauntlet of prejudiced opponents who will exhaust a considerable ingenuity in making the worse appear the better reason; and partly because economics and business are supposed to be synonymous. The businessman, in consequence, asserts the competence of his judgment in matters which frequently are on or beyond the periphery of his knowledge and experience, and the majority of the population concedes his claim.

In the application of economic principles we have never had competent leadership, and a quite inadequate effort has been made to provide it. So far as our troubles arise not from a conflict of interests, but from sheer confusion in vulgar errors, the remedy is at hand in the coordination, diffusion, and use, of informed opinion.

#### ORGANIZATION OF EXPERT OPINION

The potential innovator in the social sciences scatters his real or false pearls before his fellowship and the world at large. If the "gems" are counterfeits they may be assiduously peddled by some charlatan who sees a chance to make a good thing out of them at the expense of someone else. But, if the gems are real, it will be a fortunate occurrence if they do not soon fall into some dark unfathomed cave. There is urgent need, therefore, for the organization and recognition of a corps of experts capable of formulating the collective judgment of students of social problems, of keeping interest lively, and of effecting a liaison between thinkers and doers. The functions of such an organization would be: (1) to examine and report upon any intellectually respectable proposal for social amelioration; (2) to propagate such reports and seek to compel sustained consideration of them; (3) to undertake supplementary research, wherever preliminary reports indicated that this was necessary to soundly conceived action, but to guard against the common vice of shelving desirable but difficult decision in an escapist "recommendation of further study."<sup>3</sup>

<sup>3</sup> We shall never solve *any* problem if we wait for perfect knowledge. The more knowledge the better, of course, but further study should, in most cases, be an accompaniment of, rather than a substitute for, action. A business leader once tartly summed up in the following words the contribution of a noted economist to a discussion of ways and means of emerging from depression: "We ought first

In the preparation of reports, the organization, through special committees appointed for the purpose, would call on both orthodox and unorthodox cognoscenti for opinions and, to secure well considered opinions, it should be prepared to pay adequately for the time and effort involved in their preparation. All such opinions should be exchanged among their authors for mutual criticism and the criticisms should be submitted to the original authors of the opinions for their consideration and comment. A rapporteur *ad hoc* would be appointed to gather and consolidate the revised opinions and to submit his own preliminary report to each of the contributors for review. All members of the organization not hitherto involved should then be given the opportunity to discuss with the rapporteur a revised report which he would send them. Revising once more, to incorporate any well buttressed opinions so received, the rapporteur would submit his final report to the original contributors either for their signature, with or without reservations, or for their refusal to sign.

In most cases, no doubt, depending largely on the emotional bias toward caution or venturesomeness of the persons concerned, conflicting majority and minority reports would be inevitable. Even these, however, would have the virtue of sharply defining issues, for the ultimate choice of the electorate, and would have involved a thoroughgoing consideration of what could be said against the view to which either group finally adhered.<sup>4</sup>

The work of propagating the reports would, of course, require the active support of all members of the association and the use of every device of publicity.

Not only could such an organization work wholeheartedly for the adoption of reforms on which there was substantially complete agreement among its members but even its split reports would provide alternative standards to either of which men who aspired

to commence to get ready to begin to prepare to study the problem of approaching the task of analyzing more scientifically the possibility of undertaking to examine the question."

<sup>4</sup> The academician is a timid, opinionated, and somewhat jealous animal. Any consensus, even of only a substantial minority of them, on any program marked by a bold break with use and wont, is, therefore, a tribute to its worth. The minority opinion, in fact, will very probably be of greater merit than the view of the majority. The one case in which there will be practical unanimity will be in the condemnation of worthless proposals.

to be statesmen might repair and about which they could rally their forces.

One of the tragic features of our social life is the comparative helplessness of political leaders in any search they may make for reliable programs, or aides, in alleviation of the evils with which society is afflicted. Their choices, both of persons and expedients, are determined largely by accident or by prejudice. The opinions they receive, whether on the whole good or bad, are more or less unique and the resulting programs are always attacked on partisan grounds. Both the opinions and the programs would command much greater support if the opinions emanated from a group which included all those who might reasonably be supposed to have special knowledge of the subject but yet had no axes to grind.

#### THE PROBLEM OF LEADERSHIP

The problem of leadership is, in every society, a continuing problem. The notion, prominent in egalitarian circles, that one man's opinion (on any topic) is as good as another's is, of course, tragic nonsense. No sane person imagines that the opinion of the majority, of even the most intelligent and best-educated populations, is of much value on any but the simplest and most basic issues. The truly wise and great opinions, on any complex issue, are clearly confined in the beginning to a tiny minority or even to a single individual. Wise leaders cannot exert their talents except through intelligent followers. Social progress is therefore quite as much dependent on informed and enthusiastic followers as it is on leadership. The machinery for enlisting an expanding, assiduous, loyal, intelligent, and willing following for a comprehensive and continuing program of social reform is, so far however, conspicuous by its absence.

A fair and open hearing of all respectable proposals for social action, with an equal opportunity for the expression and consideration of the views both of the recognized savants and the unheralded wise or clever, would in itself lay the groundwork for an advance in applied social science. The efforts of an organization patently and disinterestedly concerned to discover merit, to develop the consensus, or discord, of conversant opinion on proposals for public action, to make effective any consensus that might appear, and to define, precisely, the issues on which opinion was

more or less evenly divided, could consolidate this advance and offer promise of a steady forward march in the application of ideas to the conduct of public affairs.

The formation of such an organization is clearly the task of the universities and learned societies, since they alone among social institutions profess to have no object other than a single-minded search for truth. It is not without reason, perhaps, that the cynic sneers at these professions. Constructive action, however, requires working with the materials at hand even while we endeavor to improve them. The universities and learned societies are not free from the pressure of private, or group, interests but they are probably less biased, or venal, than any other institution. It is sometimes supposed that they cannot, as institutions, properly "take a position" on any issue, but there is certainly no reason why their members should refrain from participating in an *ad hoc* organization such as that which is here proposed. This would establish the ends without which work in the social sciences must fail of application.

There is truth in the sneer that engineers "tell you how to get things done but economists tell you that you can't." The whole genius of the latter profession, as things now stand, is directed toward sniping. Critics carp at the lack of absolute perfection in the object of their attack and think that they have damned a proposal irrevocably if they can prove that it is not immaculate. The critic's word is usually the last. The result is nothing but stagnation. The task of constructive coordination, on anything approaching an authoritative basis, is unperformed. Society, in consequence, blindly gropes its way toward repeated disasters—including that of slavery as a means of solving chaos. Somehow or other the impasse must be broken along rational rather than passionate lines.

#### PROBLEMS INVOLVING CONFLICTS OF INTEREST

Where problems arise not from sheer confusion but from conflicts of interest the difficulty of attaining a socially sound solution is, of course, immensely increased. The only hope lies in the maintenance of such a diffusion and balance of powers among conflicting private interests as to give weight, as arbiter, to any group inspired by a genuine zeal for the social welfare. Here again an

articulate and continuing organization of socially-minded individuals could exert an influence which, in the long run, might work wonders. Holding a steady course toward a generally defined end, it could slowly give a social shape to institutions.

#### INEVITABILITY OF GRADUALNESS

The beneficent revolutions in human affairs are more often the result of a long trend than of any sudden change. The latter is usually followed by reaction, and synthesis takes time. The important thing is not to lose sight of goals and to get things moving, even glacially, in the right direction. Gradualness is by no means typical of a worsening of social conditions but it is all but inevitable in their amelioration since it takes many years to build what can be destroyed in an hour. A certain continuity of responsible leadership is thus essential for a movement from strength to strength. This can be provided only by an ageless corporation set up for this specific purpose. It is all too true that, in the past, everybody's business has been nobody's business. The necessity for a well knit and resolute group, committed to the public interest as its own, and serving as a guardian thereof, is urgent. A permanent steering committee devoted to diverting into socially beneficent channels, where this is possible, the dynamic thrusts of self-interested private groups, and to thwarting such thrusts when they cannot be turned to social account, could be of immense value to the republic. The power to effect social purposes will inevitably be furnished by groups exerting pressure in their own interest but, if the machinery for concerted social action were at hand, this power could frequently be canalized toward social objectives (rather than exclusively to private ends) by those with an appreciation of the requirements of social welfare.

Political and economic power, if kept separate under a democratic system of essentially free enterprise, are natural antagonists of not unequal strength. Political power rests fundamentally on numbers, and economic power on quality. Concessions must be made by those of quality to attract to their standard the necessary numbers and by the numerous to attract to theirs the necessary quality. In these circumstances the "impartial observer" will have an opportunity to determine the character of the mutual conces-

sions to be made.<sup>5</sup> An active nucleus of socially-minded citizens, quick to resent injuries to others and to defend the rights of those others as the sole guarantee of their own, can make its influence count by throwing its weight to one side or the other in the ceaseless shifting of alliances under which peaceful and rational change can alone be effected.

With the solution of the problem of unemployment, the plundering of the masses will be automatically assuaged, while the mass disposition to "soak the rich," regardless of their merit, will be much less passionately felt. In such an environment, it may not be naive to look forward to the progressive reconciliation of power and freedom.

In view of the fact that the social interest has no natural guardian, the progress already made under a balance of powers is, in some fields, surprisingly great. Inheritance laws, for example, are, in many countries, including the United States, now within sight of the goal outlined in Chapter VI. Tax rates on the largest estates have within three decades risen from little or nothing to levels

<sup>5</sup> The "impartial observer" is a prominent character in Adam Smith's *The Theory of Moral Sentiments* (A. Millar, London, 1759), and is the upholder of the moral code. Any institutions interested in morality, such as the churches, might be expected to give him strong support.

Smith's code of morality, based on sympathy and antipathy, was, it is true, cogently and mercilessly attacked by Bentham as being nothing more than a statement of personal predilections. The same criticism was brought to bear against a morality based on the supposed commands of God since, as Bentham pointed out, these were promulgated by vicars who (typically) consulted only their own prejudices as a means of discovering God's will. The alternative that Bentham offered, Utilitarianism, could be accepted, by all groups, only so long as the question, utility for what?, was not insistently pressed. Bentham's answer, of course, was utility for the securing of pleasure and the avoiding of pain and he construed these terms so broadly as not to do extreme violence to the Stoic, as compared with the Epicurean, code. But, if pleasure be not accepted as the goal of humankind, there is no more validity in Bentham's criterion than in that of Smith or those of the several religions. The fact is that no observer could be impartial, as between two contestants, unless all three agreed on certain fundamentals. Whatever the observer's basic views, they will inevitably coincide more fully with those of one than with those of the other contestant whenever there is any sharp difference between the latter. The allegedly impartial observer does not live in an emotional vacuum and his mind cannot be completely *tabula rasa*. This is why the essentials of universal agreement were laid down early in this book. On the basis of a practically universal creed, impartiality is possible.

which approximate confiscation.<sup>6</sup> Once the rates have, in exigent fiscal circumstances, been raised, the case against a reversal becomes overwhelmingly strong since the inequity of discriminating against the legatees of those decedents who happen to pass away in a period of great fiscal need is obvious to all.

In many other ways the advance toward social goals is merely a matter of momentum. Backsliding is more often the consequence of social blindness than of private malevolence. So far as a population can be made socially alert the greatest evils may be turned to social account. It is, for instance, an error to suppose that wars must inevitably result in social retrogression. On the contrary, it is frequently possible out of this nettle to pluck flowers that would otherwise go ungathered. War is, in many ways, a great socializer. The ultimate social problem, in fact, is to establish its beneficent equivalent. If a sustained assiduity in the social interest can be developed, however, we may leave to the diamond its ages to grow—without undue worry about the ultimate result.

<sup>6</sup> The actual collections made, to date, under these laws would seem to show that the bark of the statutes was much worse than the bite. In one way or another they have been widely evaded. We may hope, however, that the loopholes will be steadily closed.



## CHAPTER XIII

### REVIEW AND CONCLUSION

THE Liberal faith of our fathers, living still, rests on the twin pillars of rationalism and a conviction of the inherent worth of the individual. Individualism was to furnish ubiquitous and ever-welling springs of power and rationalism to ensure its free and social coordination.<sup>1</sup> Liberalism reached its temporary zenith toward the end of the nineteenth century. The decline since that time is, in part, attributable to an inadequate grasp of essential concepts but, in larger measure, to the fact that institutions have increasingly tended to destroy the ideas they were fondly supposed to embody. The simpler institutions of the past can never be fully recovered. With whatever nostalgia we may look back upon a "golden age," history does not and cannot be made to repeat itself in any but the very broadest outline. Yet, though it be impossible to put new wine into old bottles, we may well put old wine into new bottles if the wine is good and we have the wit to fashion the fitting container. The wine of Liberalism has not lost its savor. The values of Liberalism can, however, be preserved only in a repudiating of resolute allegiance to them and in the molding

<sup>1</sup> Rationalism, as contrasted with reason, is best construed, narrowly, to cover nothing more than reason in *social* affairs. Reason, as a *self-regarding virtue*, means the cerebral power and lucidity which enables men, through close and unclouded observation, to trace sequences to their lair; to make fruitful surmises of such sequences even when they cannot actually be observed; to develop effective means of attaining given human ends; and, in the form of rational imagination, to prescribe new ends. It is in this sense that all the natural sciences are rational, and the use of reason of the self-regarding sort is the preeminent characteristic of the scientific attitude. Such reason is objective in attitude. Reason, as a *social virtue* (rationalism) is, on the other hand, subjective in attitude, involving a preference for the peaceful solution of conflicts either over no solution at all (continuous fighting) or a solution through triumphant force and guile. Reason in this sense can have no existence except there be an agreement between contestants on certain ethical postulates as a basis of equity or justice. Equity, or justice, is, in fact, synonymous with rationalism as the reconciler of the fundamental and universal wills to power and (therefore) to freedom. Since power-cum-freedom, as the essence of social goals, is possible of attainment only through equity or justice, so it can be achieved only through rationalism, their synonym. It is in this latter sense that the natural sciences are *a-rational* and are frequently described as *anti-rational*. Equity and justice are irrelevant to them; their subject matter is matter of fact not matter of right. Reason, as a self-regarding virtue, is a tool of will; rationalism is the will to realize, in a social scheme, the manifold wills of individuals on the assumption that every individual is an end in himself.

of institutions to further their consummation. Much has been written about our present-day lack, and need, of faith. We *have* a faith, though hope deferred has made it faint. What is needed is not so much the creed as the practice of it, and we can learn to practice it only on the basis of a clear apprehension of the forces that have turned the aspirations of yesterday into the disillusionments of our own bewildered time.

It is doubtless true that the failure of Liberalism is not to be laid exclusively to inadequacies of method. The original confidence in the sovereign power of reason, and in the essential rationality of man, erred on the side of optimism, yet a more sober appraisal of the limitations of reason as an instrument of social action need not evoke despair. Whatever the limitations of reason, as a social virtue, there is, in any event, no decent substitute for it. So far as such reason fails, or is spurned, the magnitude of social problems grows, and bitter experience with alternative "guides" to social action may be expected to give to social reason an ever larger role as time goes on.<sup>2</sup>

The excessive optimism of the early Liberals arose primarily out of a philosophy unduly influenced by the triumphs which the physical sciences were currently recording. As applied to the social world, this philosophy pictured the social order as underlain by a system of natural, and essentially beneficent, law. The task of the social engineer was therefore conceived to be, first, the discerning of the structure of the natural order, and second, the mere removal of obstructions to the free play of natural forces. This was, of course, an extreme of over-simplification of the task of creating a liberal society. It implied that the good life was a free gift, to be plucked from the tree of nature, rather than the result of the continuous, and often self-frustrated, upward struggle of man.

The reliance on natural law, with its implications for sociological method, has had a most unfortunate influence on the development of all the social sciences, particularly economics. However vigorously the assertion may, in some quarters, be denied, it is fair

<sup>2</sup> We must always keep in mind, however, that "Fanaticism never sleeps: it is never gluttoned: it is never stopped by philanthropy; for it makes a merit of trampling on philanthropy; it is never stopped by conscience; for it has pressed conscience into its service. Avarice, lust, and vengeance, have piety, benevolence, honour; fanaticism has nothing to oppose it." Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* (W. Pickering, London, 1823), vol. 1, p. 280.

to say that the doctrine still survives as the libido of much of the contemporary work in that field. This is the principal source of its negative character. The shadow of the concept of natural law has almost inevitably caused economic analysis to serve as the unwitting tool of a rationalization of things as they are. The science has thus become not only dismal but slavishly discreet. The nineteenth century conception of the task of the scientist as the discernment of the "immutable laws" of nature has given support to a methodology of "pure" description rather than to that of a study of techniques for the attainment of consciously adopted social ends.<sup>3</sup>

These strictures on the Liberal position suggest a shift in emphasis, both in the attitude toward social problems and in the method of attack, but they do not imply the need of any deviation from the goals which the early Liberals saw clearly in an all too rarefied air. The task at hand is greater than they supposed and the tools they thought they had have proved imaginary. We may indeed concede that such freedom as has been accorded to, or won by, the individual, together with all of what may be loosely called the democratic way of life, was in no small degree the result of a series of happy historical accidents. The problem of preserving the values of Liberalism in the contemporary world may therefore be of greater proportions than that of their not inconsiderable realization in the heyday of modern democracy. There is, in any event, no presumption that the drift of institutional events, the "natural forces" of the social order, will promote the values of Liberalism rather than those of any other social ethic or that it will lead to an

<sup>3</sup> The eighteenth century philosophers were so impressed by Newton's work in the physical sciences that they imagined that the moral law was to be discovered in a similar way and by the same methods. The machine-like processes of celestial mechanics led them to believe that it was not man's business to make laws but merely to find them out and permit their unconstrained operation. This attitude is reflected, in court decisions, to the present day. Men were to act in accordance with the laws of nature and thus in harmony with the nature of nature's God. It is only gradually that recognition has been given to the facts that human standards, of good and evil, are alien, and even hostile, to the course of nature and that the distinctively human achievement is the conquest of, rather than adaptation to, the restrictions imposed upon man by natural phenomena and "natural" attitudes. Strong vestiges, and even resurrections, of the earlier epistemology are still present in many (allegedly) intellectual quarters. These notions, derived from an unwarranted extension of Newton's *principia*, received, indeed, a new lease of life from a similar monism in indiscriminating applications of Darwin's discoveries.

equilibrium of perfect competition rather than to that of tyranny or chaos. The framework of the liberal society is not a gift of nature; it must be a rational order imposed by socially-minded men on the otherwise a-moral data of the struggle for survival and for power.<sup>4</sup>

The less sanguine the view that must be taken of the beneficence of natural forces, the greater the need for social rationality. The only alternative to social reason, as a means of delineating problems and seeking their solution, is an attempt to gain social cohesion through violence, mysticism, or mass romantics. The progeny of two such romantic movements, Communism and Nazism, is now full-grown. It should be recalled that the actual governing authority in any modern state is a tiny minority of the whole, or even a single individual. Communism not only generates blind allegiance to such an authority but to the idealized omni-virtuous class of which the authority is presumed to be the agent. The obverse of this allegiance is an equally blind hatred of any allegedly omni-malevolent system in which the favored class is not in complete control. Nazism achieves a similar result by idealizing the nation, culture, blood, race, and "Leader" and by providing an outlet for social ferment in bitter antipathy to those outside the self-designated, and insufferable, elite. Neither system permits any criticism of its unifying romance and neither affects to offer salvation except after a cataclysmic ushering in of a darkly nebulous future. If man's resources for rational social action are so limited as to drive him to these expedients he is indeed undone.<sup>5</sup>

The Liberal emphasis on the individual, like the emphasis on reason, is, in its more profound implications, of preeminent im-

<sup>4</sup> "There is only one kind of people with whom I care to live or die; only one kind . . . whom I can ever hope to trust or depend upon; only one kind . . . whom I can safely count among my friends. They are not those who insist upon playing things safe to the very end. They are not those who daily practise a personal compromise with . . . inhumanity. . . . They are not those who insist that . . . any nation can preserve its soul through glorification of materialism. They are those, and those alone, . . . to whom freedom of the human spirit means the attainable and the coming dawn of a new world." Leland Stowe, *No Other Road to Freedom* (Alfred A. Knopf, New York, 1941), p. 330.

<sup>5</sup> Those who despair of social reason may well remember that the vulgar are sometimes wiser than the learned since their minds are less capable of "forging their own shackles." cf. Lewis Mumford, *Technics and Civilization* (Harcourt, Brace and Company, New York, 1934), p. 29.

port. A tender regard for the social individual, and his rights, is a *sine qua non* of a permanently stable and progressive society. Without some ground on which individuals, and groups, may meet as equals, the struggle for coercive power must relegate social objectives to the limbo of dead or unborn things. Liberal thought starts from the humanistic idea that all men, simply as men, are, in certain essential aspects, equal. Though this concept was originally clothed in the now outmoded verbiage of "natural" rights, it has lost none of its validity with the shedding of its pristine garments. The most familiar expression of the faith is to be found in the Declaration of Independence in the words "We hold these truths to be self-evident, that all men are created equal . . . [and] endowed by their Creator with certain unalienable Rights." Its most classic exposition is in Locke's description of the state of nature: "A state also of equality, wherein all the power and jurisdiction is reciprocal, no one having more than another, there being nothing more evident than that creatures of the same species and rank, promiscuously born to all the same advantages of Nature, and the use of the same faculties, should also be equal one amongst another, without subordination or subjection. . . ."<sup>a</sup>

Practically all the early Liberals believed, with Locke, that in a "state of nature" (that is, where no exclusive property rights had become effective) men would be so amiable, or so equal in strength, as to preclude a socially noxious use of power. The consequence was that they imagined that competition, uninhibited by political intervention, would be synonymous with free (i.e.

<sup>a</sup> John Locke, *Of Civil Government*, Second Treatise (J. M. Dent and Sons, Ltd., Everyman's Edition, London, 1924), chap. II, p. 118.

Locke's sensationism as the basis of all mental states, with its corollary of the determination of character by (social) environment, had misled him into the belief that there were slight, if any, differences in the natural endowment of individuals. Given appropriate institutions, all men would, therefore, become as good as the best. This optimism was reflected in Adam Smith, and most of the other philosophers of his age, who thought in terms of the perfectibility of society as well as that of the individual. A starkly pessimistic note was introduced by Malthus, while Darwin, whether to be construed as optimistic or pessimistic, wrote *finis* to the idea of the equal natural endowment of men. The conviction of the materialistic determination of human actions, however, was strengthened by Darwinism and reached its apogee with the vogue of behavioristic psychology. But "ethical nature, while born of cosmic nature, is necessarily at enmity with its parent." cf. Thomas Henry Huxley, *Evolution and Ethics* (D. Appleton and Company, New York, 1914), p. viii.

high-level) competition in the economic sense of the term. Their position was not, perhaps, illogical but it was tragically inadequate. The essence of free competition is the distribution of power so that no private individual may exert it in other than socially productive, or socially indifferent, ways. There was no truth in the assumption of the early Liberals that such a distribution of power, and that freedom, would be the outcome of a thoroughgoing *laissez faire*.

The equality of men is, thus, not quite so self-evident as it was once alleged to be; its assertion, even in modified form, is rather an act of faith, a postulate of practical social reason, springing from the sentiment of human solidarity which "is the analogue, in the realm of feeling, of impersonal curiosity in the realm of intellect."<sup>7</sup> But, however much the expression of the idea of equality is in need of amendment, the insight into its necessity as a basis for social action shines out as clearly now as on the day the gospel was first set forth.<sup>8</sup>

As significant as the idea of equality, in the Liberal conception of individualism, is the Liberal doctrine of motivation with its far-reaching implications for social organization. With full recognition of the indispensability of inculcating, as widely as possible, the spirit of the "impartial observer," the Liberals sanely realized that "every man is . . . by nature first and principally recommended to his own care."<sup>9</sup> The tragic results that follow for men in the irrevocable committing of their lives to the care of others—to a party or a "Leader"—need no emphasis, perhaps, in the present state of world affairs.

The Liberals knew that altruism could not constitute the sole, or even primary, motive either to individual action or social organization. To interpret this doctrine as implying that man is unquali-

<sup>7</sup> Bertrand Russell, *Power* (W. W. Norton and Co., New York, 1938), p. 250. Russell calls this sentiment "universal sympathy" but this terminology is not unobjectionable.

<sup>8</sup> The core and justification of equality of opportunity lies in the necessary assumption, by all socially conscious men, of equal obligations for the maintenance of common rights.

<sup>9</sup> Adam Smith, *The Theory of Moral Sentiments* (A. Millar, London, 1759), p. 181. cf. also, Jeremy Bentham (*An Introduction to the Principles of Morals and Legislation*, W. Pickering, London, 1823), vol. 1, p. 278, where he says that "the motives, whereof the influence is at once most powerful, most constant, and most extensive, are . . . all of them self-regarding motives."

fiedly self-centered, as has often been done, is to indulge a complete misconception of its real import. Men are clearly capable of great sacrifice, even of life itself, in the service of ideals with which their material well-being is in no way associated unless adversely. But this is not denied in Liberal theory. The wisdom of the Liberal position lies in the fact that the modal individual has neither the intellect to grasp the full implications of the role of impartial observer, or actor, nor the imaginative capacity or will to play that role, day in and day out, in all his social relationships through all his life. Complete objectivity, moreover, is not only impossible but, if it could be attained, undesirable. No man can regard his own interest, and that of those most dear to him, with the impassivity with which he would look on that of the individual farthest removed from him in space, time, and kind; and, even if he could and did, he would be universally regarded as a renegade to his duties. With the majority of men, moreover, the need of sustenance, and of a modicum of comfort for themselves and their immediate dependents, absorb the bulk of their energies and must, inevitably, engross a large share of their attention.

In the economic world this suggests that, whatever the form of organization and whether it be based on public or private ownership of property, the most urgent incentives for the individual will always be, to a large degree, self-centered. Remuneration, in some form, must therefore be tied to performance rather than to needs. This does not mean that economic life must be conducted on the jungle level or that "economic man" will be void of social conscience. It implies nothing more nor less than that reward shall correspond with merit. If rewards were made to square with "needs," then avidity, profligacy, weakness, and lustful appetite would be the principal criteria of remuneration, and the economically virtuous would be ruthlessly plundered by their economically vicious "fellows."<sup>10</sup>

<sup>10</sup> It would, no doubt, be possible to set up a standard of (biological) needs which would not differ greatly from individual to individual. But, if men were required to contribute, according to their abilities, to a pool of production, out of which their mere biological needs were met, they would either remain, as a society, at a subsistence level or there would be but a partial draft upon the pool. The crucial issue would then arise over the disposal of the remainder of the goods in the pool.

If the early Liberals erred at all in their appraisal of the problem of economic motivation it was in the ease with which they thought that self-interest could be harnessed to the general welfare. To permit individuals to follow their own devices, in any milieu other than that shrewdly designed to promote thereby the social welfare, will no more result in social benefit than will the Marxian class conflict issue in a classless harmony of interest. So far as social order issues out of the pursuit of individual interest it must be implied in the institutional framework within which the free play of individual choice takes place. No pattern of institutions will suffice forever and it is the function of the social scientist to furnish the pattern which, in *his* day, will provide a balanced power and the maximum of individual freedom in equity.

If a liberal world is to survive at all it must effect such a transformation in its institutions as to bring them into as close correspondence with Liberal principles as stubborn fact permits. Unfortunately, many of those who loudly protest their Liberalism are in truth intent upon preserving institutions of privilege which are a denial of, and are certain to destroy, the values they pretend to cherish. For this reason, the term "Liberalism" has of late come to be regarded as almost a synonym for the obstruction of social purposes. If the words "liberalism," "individualism," "democracy," and "free enterprise" are to be associated only with a rigid adherence to certain forms from which the liberal substance has long since passed away and, if all deviations from those forms are to be condemned, then "Liberalism" is already dead and will become merely a name to be attached to an attractive historical epoch. If, on the other hand, the fundamental tenets of Liberalism—the product of profound insight into the basic problems of social incentives and the implementation of socially valid power—can be made effective, they will prove to possess inter-temporal, if not eternal, value and can furnish a continuous frame of reference for the necessarily continuous process of institutional readjustment.

As the fruits of alternatives to the Liberal tradition have ripened in continental Europe and the Far East, that which, for want of a better term, may be called the common-sense of Liberalism is making a renewed appeal, in the countries where the faith was first nurtured, as the sole alternative to slavery or war without surcease. There is, in the traditionally democratic countries, a grow-



ing appreciation of the value of a social heritage which, in the relatively stable, prosperous, and not distant past, had been taken for granted. History is once more demonstrating that concentrations of irresponsible power, either political or economic—and the one begets the other—may overcome temporary social stagnation or chaos only at a practically prohibitive price. The greatest peril, perhaps, is that a sudden awakening to the value of what is now endangered by obvious force will provoke an irrational tendency to cling blindly to what always were, or have now become, imbecile institutions. If such is the case the measure of freedom that we have will be taken away quite as effectively by its enemies within our midst as it could be filched by foreign foes.

"The economic problem, the struggle for subsistence, . . . has been . . . the primary, most pressing problem of the human race [and] not only of the human race, but of the whole of the biological kingdom from the beginnings of life in its most primitive forms."<sup>11</sup> Few will deny the truth of these words of an economist with whom the present writer has here found himself bound, on occasion, to express sharp disagreement but who has been a veritable Aeolus in letting fresh winds into the stuffy precincts of neo-classical economics. It is perhaps premature to go farther and worry with him about what men will do with themselves when they no longer have to cope with a situation for which they have been prepared by nature in the evolution of all their impulses and deepest instincts. Yet we may fully agree with his conclusion that, *if we can stop wars and an excessive growth of population*, the most urgent economic problems are within sight of solution.<sup>12</sup> If we could count on even a fairly lengthy respite from wars, and the establishment of conditions under which the outbreak of international violence is not an ever-present presumption, it would, in the

<sup>11</sup> J. M. Keynes, *Essays in Persuasion* (Harcourt, Brace and Company, New York, 1932), p. 366.

<sup>12</sup> *loc. cit.* The increase of population, to a point where pressure on the means of subsistence is great, does not now seem probable to those who have been watching the trend in the western world in recent decades. But it should be remembered that the phenomenon of stationary or falling population, not subject to positive checks on growth, is of limited scope, both in space and time, and that, on a broad view, the gloomy views of Malthus may be fully warranted. If major wars are recurrent we can expect widespread and drastic measures to increase the supply of cannon-fodder, and communities which are reticent in this matter may go down before those which are expansive. In any case, the standard of living would fall.

economically more advanced societies, be readily possible to provide a minimum scale of living amply sufficient to furnish to all the material requirements of the good life. This is purely a matter of administration.

Acquisition of the material requirements of the good life is, of course, not enough for its achievement. The way in which material necessities are acquired, and the use made of them when they are attained, are equally important. The scale of living is to be measured not only in terms of consumption but in the human cost of acquisition of the goods consumed. That cost will be low in the degree in which the individual is free. The provision of the material requirements of the good life must therefore be made in an atmosphere of freedom or the good life inevitably fails. It may fail, of course, in any event. Men can never be released from their own limitations. "It is possible for multitudes in time of peace and security to exist agreeably . . . to drift along . . . hoping for the best, and believing in nothing very much. It is possible [so] to be a passable citizen. [But] serenity of soul requires some better organization of life than a man can attain by pursuing his casual ambitions, satisfying his hungers, and for the rest accepting destiny as an idiot's tale in which one dumb sensation succeeds another to no known end."<sup>18</sup> Serenity of soul, however, is an individual, not a social, matter. Though almost all moralists have extolled a measure of asceticism, asceticism is necessarily self-imposed and, whatever the virtues of renunciation, they cannot be attained unless one has the opportunity to renounce. There is nothing to prevent renunciation in the presence of abundance but there is no virtue in mere resignation to an enforced or indolent poverty. The social task is to provide the conditions under which a choice is possible; the choice is the individual's; and choice is as essential to morality as it is to life.

It may be that men are presented with an incorrigible moral dilemma in that the conquest of bread would permit and lure them to eat the cake on which their powers might atrophy. But the beauties of poverty are more readily comprehended by the rich than by the poor and the modal standard of living might be raised very considerably above even its *potential* current level without

<sup>18</sup> Walter Lippmann, *A Preface to Morals* (The Macmillan Company, New York, 1929), pp. 7-8.

danger of widespread corruption. There is no convincing evidence that the morality of the slum is superior to that of Main Street or that that of Main Street would grow worse in better houses.

On the contrary, it seems to be true that the higher the modal economic income of a people the greater the expansion of powers in every direction. Materialism, for a time, may absorb all energies but, as material welfare increases, a proliferation of interests develops and a great society begins to blossom.

As Lewis Mumford points out in his *Technics and Civilization*<sup>14</sup> not "until the economic process reaches the stage of creation—not until it supplies the human animal with more energy than he needs to maintain his physical existence, and not until still other energies are transformed into the more durable media of art and science and philosophy, of books, buildings and symbols—is there anything that can be called, even within a limited span of time, a gain. . . . The permanent gain that emerges from the whole economic process is in the relatively non-material elements in culture—in the social heritage itself, in the arts and sciences, in the traditions and processes of technology, or directly in life itself, in those real enrichments that come from the free exploitation of organic energy in thought and action and emotional experience, in play and adventure and drama and personal development—gains that last through memory and communication beyond the immediate moment in which they are enjoyed. In short, as John Ruskin put it, *There is no Wealth but Life*; and what we call wealth is in fact wealth only when it is a sign of potential or actual vitality." Production, and social organization, are but a means to these larger ends and, as Mumford is at pains to stress, we must be wary of here again falling into the trap of making an end of our means and of forgetting what we are really after.

With certain more or less insoluble problems of society, however, this book is not concerned.<sup>15</sup> The indispensable preliminaries

<sup>14</sup> Harcourt, Brace and Company, New York, 1934, pp. 376, 377 *et seq.* This is a stimulating book though it is marred by millennialism, that is to say, a tendency to set up a Utopia which would require archangels, rather than men, as its raw material.

<sup>15</sup> Such would be, for instance, the composition of future society. The pursuit of a progressively more abundant life is tied up with eugenics and social selection of all forms of socially innocuous competence. It is certainly desirable to effect a gradual change from what, by present standards, may be held to be a C<sub>3</sub> population to

to a good life for the common man must be provided before doubts as to whether, when he had them, he would, in fact, achieve it can be of pressing import. These preliminaries involve, in the writer's view at least, the establishment, within a given society, of the irenic conditions implicit in the Liberal philosophy.

The program of reform here presented is an attempt to describe an institutional mechanism which might serve as an embodiment of Liberal values for these times. Like all proposals which do not promise an impossible Utopia it represents a compromise between unattainable ideal and existing fact. Sufficient cognizance has, it is hoped, been taken of real and relatively unchanging human traits to make the program a feasible design for democracy. The further hope may perhaps be expressed that, in application, the approach to the ideal may so modify the present fact as to provide a dynamic for all those who, though they have deeply drunk at the Liberal spring of faith in freedom, equality, and brotherhood, have yet some need of occasional refreshment with the nectar of social progress.

Let us not forget the warning that a race preserves its vigor only so long as it harbors a real contrast between what has been and what may be and is nerved to adventure beyond the safeties of the past. Once such a spirit of adventure is lost, a civilization is already in full decay.<sup>16</sup>

what, even by much higher standards, would be considered to be A<sub>1</sub>. But such a change could not be effected quickly, if at all, without considerable violence to the "rights" of individuals. It is of supreme importance that society move in the direction of improvement of the human stock, and a measure of social control may be indispensable to this end, but what the control should be is probably incapable of accurate definition. The one certain thing is that force should be banned or, at the very least, held to the minimum necessary to prevent social degeneration.

<sup>16</sup> cf. Alfred North Whitehead, *Adventures of Ideas* (The Macmillan Company, New York, 1933), p. 360.



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